INDIAN MONETARY POLICY AND THE INTERNATIONAL LIQUIDITY CRISIS DURING THE INTER-WAR YEARS (1919-1939).

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ABSTRACT OF THESIS

INDIAN MONETARY POLICY AND THE INTERNATIONAL LIQUIDITY CRISIS DURING THE INTER-WAR YEARS (1919-1939).

This thesis examines the multi-lateral considerations that, in our view, underlay the formulation of monetary policy in India in the period between the two world wars. During and after the First World War, Britain faced a severe liquidity crisis. We argue that monetary policy in India was formulated to take account of this crisis. Traditionally, India was a large absorber of gold on the non-monetary account. The persistent aim of British monetary policy in the Indian context during the entire inter-war period was that of not allowing India to set up a monetary demand for gold in addition to her non-monetary demand for it and secondly, through deflationary policies (including exchange rate adjustments), to limit India's non-monetary gold demands to the minimum. Indian gold exports during the depression, which gave room for manoeuvre in the management of the sterling after September 1931, were a logical sequel to this policy.

The British liquidity crisis in this period took the form of her current account surpluses being inadequate to support a high level of overseas lending. Besides, in an uncertain financial environment, Britain was a large short-term debtor as the British bank rate acted as much to increase her short-term liabilities as it did by calling in her short-term assets. The British desire to return to gold at the pre-1914 parity required domestic deflation which itself was a matter of severe political contention. In the circumstances, Britain hoped her return to gold would be

accomplished by a US inflation and US export of capital. Compounding this situation was the thinly veiled fear, in Britain, of the erosion of the key currency role of the sterling and the loss of its global financial leadership to the USA. Control over Indian monetary policy and its outcome proved valuable to Britain in this environment.

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G.Balachandran

TABLE OF CONTENTS

LIST OF TABLES

LIST OF ABBREVIATIONS

The following abbreviations have been used in the text and in the bibliography.

AER	American Economic Review
AHR	American Historical Review
BNDLQR	Banca Nazionale del Lavoro Quarterly Review
CCA	Churchill College Archives
CEHI	Cambridge Economic History of India
CSSH	Contemporary Studies in Society and History
EHR	Economic History Review
EJ	Economic Journal
EPW	Economic and Political Weekly
EEH	Explorations in Economic History
Htry	Hawtrey Papers
IEJ	Indian Economic Journal
IER	Indian Economic Review
IESHR	Indian Economic and Social History Review
IJE	Indian Journal of Economics
IOLR	India Office Library and Records
JAH	Journal of American History
JAS	Journal of Asian Studies
JCH	Journal of Contemporary History
JDE	Journal of Development Economics
JDS	Journal of Development Studies
JEH	Journal of Economic History
JEEH	Journal of European Economic History
JICH	Journal of Imperial and Commonwealth History
JIE	Journal of International Economics
JME	Journal of Monetary Economics
JPE	Journal of Political Economy
JPS	Journal of Peasant Studies
MAS	Modern Asian Studies
NMMA	Nehru Memorial Museum and Archives
OEP	Oxford Economic Papers
PRO	Public Record Office
RBIB	Reserve Bank of India Bulletin
SEJ	Southern Economic Journal
SJPE	Scottish Journal of Political Economy
QJE	Quarterly Journal of Economics

The title of a book cited in the text is given in full at the first citation. Subsequent citations give key words from the title. Due to technical problems (with the software and the printer respectively), it has not been possible to italicize or underline titles of books, names of journals or non-english words. These are instead printed in bold type as in the abbreviations above.

CHAPTER 1

Introduction : On some Theoretical, Historical and Institutional Aspects of India in the International Monetary System

I.1 The Indian Financial System
I.2 Britain and the Indian Gold Exchange Standard
I.3 The Gold Exchange Standard in World War I
I.4 The Role of Gold
I.5 Britain and the Gold Exchange Standard
I.6 Gold for India : Changing British Perceptions
I.7 Whitehall and Indian Monetary Policy

Organisation of the thesis

This study examines the influence of multilateral factors on India's monetary policy in the inter-war period. The policy not only affected the external account towards which it was primarily oriented, but also the domestic economy through its effect on prices, incomes, consumption, asset holdings etc.. For at least a decade after the First World War, the colonial administrators were still experimenting with the Indian currency system. Therefore, it is impossible to separate currency policy from Indian monetary policy during this period and we also examine the influence of global factors on the formulation of currency policy in India. In this chapter, we explore some of the theoretical, historical and institutional questions that arise in this context.

The external economic relationships of the colonial Indian economy have received some scholarly attention. However, in the questions that were tackled - namely those of the "drain" (unilateral current transfers) and tariffs - and in the approach to them, earlier works have stressed the bilateral aspects of the economic relations between India and the metropolitan country (Britain). External financial policy, according to this view, was passive in the inter-war years and was dominated by the need to ensure the discharge of India's current account obligations.[1]

With much of the nationalist criticism of British policy relating to "drain" and tariffs - both eminently bilateral questions - and with Britain looming so large in relation to India's external accounts, the above emphasis was perhaps unavoidable. On the other hand, at this time, Britain was presiding with diminished authority over a weakened multilateral payments system whose restoration and strengthening was seen as the key to British prosperity.[2]

India was an important part of this multilateral system and crucial to Britain's position within it. Her key role in enabling Britain to run a current account surplus before 1913 has been emphasized by Saul and is well known.[3] But as Britain's overall deficits increased after the war, it has been supposed that India ceased to be of use to Britain in her global financial settlements.[4] Consequently, the wider aspects of their inter-war financial relationship have been neglected.

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[1] B.R.Tomlinson, **The Political Economy of the Raj, 1914-1947 : The Economics of Decolonization in India**, London, 1979; "India and the British Empire, 1880-1935", **Indian Economic and Social History Review (IESHR)**, Vol 12, No.4, 1975, pp.337-380; "Britain and the Indian Currency Crisis, 1930-2", **Economic History Review (EHR)**, Vol.32, No.1, 1979, pp.88-106; I.M.Drummond, **The Floating Pound and the Sterling Area, 1931-1939**, Cambridge, 1981, pp.28-51.

[2] I.M.Drummond, **The Gold Standard and the International Monetary System,1900-1939**, London, 1987, p.27 and p.35.

[3] S.B.Saul, **Studies in British Overseas Trade, 1870-1914,** Liverpool, 1960, pp.56-63.

[4] See J.D.Tomlinson, **Anglo-Indian Economic Relations, 1913 to 1928 with special reference to the Cotton Trade**, Ph.d. thesis, London, 1977, pp.217-218; Tomlinson, **Political Economy**, 1979, p.44 refers to India's role in British settlements as one in a "series of ancillary points". B.Chatterji, **Lancashire Cotton Trade and British Policy in India, 1919-1939**, Ph.d. thesis, Cambridge, 1978, "The Political Economy of Discriminating Protection : The Case of Textiles in the 1920s", **IESHR**, Vol.20, No.3, 1983, pp.239-75 and "Business and Politics in the 1930s : Lancashire and the Making of the Indo-British Trade Agreement", **MAS**, Vol.15, No.3, 1981, p.528 is an exception.

This constitutes a mystifying omission which detracts from a fuller understanding of the constraints within which Indian monetary policy was made. In the inter-war period sterling's role as a key-currency and London's role as the international financial centre were both under threat. The domestic adjustments required to restore sterling to the gold standard at its pre-war parity were fraught with contention. In order to mitigate the stress of her return to gold and to continue lending abroad, Britain sought to limit or prevent absorption of the primary reserve, i.e. gold, by India. India's ability (which in this period was largely policy-induced) to set up counter-cyclical pressures on the world's reserves of precious metals stood Britain in good stead.[5] We will begin with a brief description of the Indian financial system in relation to the economy's external sector.

I.1 THE INDIAN FINANCIAL SYSTEM

The Indian economy was mainly an open one. It was uninfluential in that, in respect of most of its tradeables, it was a price-taker. India's foreign trade sector was, in relation to the economy as a whole, smaller than in other colonies. India's aggregate foreign trade was only about 17% of her national income and varied within narrow limits around this figure.[6]

However the foreign trade sector had an impact on the economy quite disproportionate to its size because of certain structural reasons and through the

[5] J.M.Keynes, **Collected Writings**, Vol.1, **Indian Currency and Finance**, (**JMK**, Vol.1), London, 1971, p.70.

[6] K.N.Chaudhuri, "Foreign Trade and the Balance of Payments, c.1757-1947", in Dharma Kumar and Desai, M., eds., **Cambridge Economic History of India (CEHI)**, Vol.2, Chapter X, Cambridge, 1982, p.804.

influence of trade on monetary aggregates.[7] When the rupee was on an automatic gold exchange standard in the years preceding the First World War, the foreign trade sector was the biggest single source of elasticity in the monetary system. With a poorly developed banking system and in the absence of a central bank, overseas financing of India's foreign trade was the major source of expansion in the busy season that ran from October to March each year. The dominance of cash and coin meant that multiple expansion was not possible in regard to a major proportion of high powered money. Although India was not subject - unlike other colonial systems - to a 100% currency cover, to the extent Indian currency expanded through sovereign imports or council bills, it was similar to a purely fiduciary system.[8]

For this reason primarily, global instability impinged on India mainly through monetary channels even when exports were the proximate variables to be affected initially. A large part of the adjustment necessary to preserve external stability was also seen to work through the monetary system. Though the fiscal system played a role especially in the 1930s, to the extent that certain fiscal charges were fixed, its inflexibility threw an extra burden of adjustment on the monetary system.[9]

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[7] K.N.Chaudhuri, "Foreign Trade", **CEHI**, p.805 and "India's International Economy in the Nineteenth Century : An Historical Survey", **MAS**, Vol.2, No.1, 1968, p.50 and R.W.Goldsmith, **The Financial Development of India, 1860-1977**, Delhi, 1983, p.9.

[8] A.G.Chandavarkar, "Money and Credit, 1858-1947", **CEHI**, Vol.2, Chap.XI, p.774. Also see **JMK**, Vol.1, p.40.

[9] The idea that both the fiscal system and the monetary system adjust to preserve external stability must seem heretical to most schools of payments adjustment. But as Eichengreen points out, while theoretical models tended to emphasize one or the other aspect of the movement towards equilibrium, the different models were not necessarily incompatible and may well have operated together in real life. See B.Eichengreen, ed., **Gold Standard in Theory and History**, New York, 1985, pp.9-10.

The nature of the Indian monetary system also complicated the impact of an external crisis. Until 1893, India had been on a depreciating silver standard. From 1898 India was on a gold standard with token silver coinage. The original idea was to introduce a gold currency into India. But this was not followed up because of British opposition.[10] The system that evolved was one in which token silver rupees were unlimited legal tender. There were two levels of token currency reflecting the projected evolution from a silver standard to a paper currency system. Token notes could be redeemed in token silver rupees at the option of the holder. This rendered the Indian currency system not only vulnerable - as other similar open economies - to external shocks but also hostage to the conditions of the silver market. But silver coins were necessary in a backward country where paper currency or bank deposits were unpopular and where metropolitan authorities hesitated to sanction a gold currency. The silver for coinage was bought in London from the proceeds of Council Bill sales. The currency in circulation was backed by silver, investments in rupee and sterling paper and gold in the Paper Currency Reserve(PCR). The currency value of the coined silver was greater than its value as metal. The coinage profits were invested predominantly in British securities and in gold as the Gold Standard Reserve(GSR). This reserve provided resources for intervening in the market to stabilize the rupee, though efforts were constantly made, in the event of exchange market intervention, to prevent a reduction of the GSR through effecting transfers from the PCR. The transfer, by diminishing the reserve, also diminished the gross circulation of currency and coin. Thus market intervention to stabilize the rupee worked its way through the monetary system : intervention to stave off bear pressures automatically triggered deflationary responses.

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[10] Marcello de Cecco, **Money and Empire : The International Gold Standard, 1890-1914**, Oxford, 1974, pp.68-70; **JMK**, Vol.1, pp.45-48; also see A.P.Kaminsky, "Lombard Street and India : Currency Problems in the Late Nineteenth Century", **IESHR**, Vol.17, No.3, 1980, p.326 and S.Ambirajan, **Political Economy and Monetary Management, India : 1860-1914**, Madras, 1984, pp.155-56,167-68.

The system in which the reserves of a country (whose currency is on fixed peg to gold or a gold currency) are invested primarily in gold currency securities and the gold currency is used as the intervention medium came to be known as the gold exchange standard. Investment of the reserve in gold currency securities removed the possibility of active gold circulation and this also became a key attribute of the system.

Though a seemingly natural evolution of a system in which the dominant gold currency (the sterling) was already the major transaction medium in the international payments system even under the gold standard, the gold exchange standard in India evolved accidentally.[11] It was justified retrospectively by Keynes and others as the system best suited to Indian needs and as being in the "forefront of monetary progress", but it was never an officially considered policy till the Chamberlain Commission (in which Keynes was a major influence) endorsed it.[12] But even the Chamberlain Commission, while supporting the existing system and acknowledging that a gold currency was not necessary for the functioning of the Indian monetary system, was loathe to rule out gold altogether. Further, it was inclined towards orthodoxy on the composition of the Indian exchange reserves and to recommend a larger gold holding in it than the India Office felt necessary.[13] Ten years later, the India Office was to call these recommendations "out of date".[14]

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[11] **JMK**, Vol.1, p.24.

[12] **JMK**, Vol.1, p.182; Royal Commission on Indian Finance and Currency 1914 (Chamberlain Commission), **Final Report of the Commissioners** (Cd.7236 of 1914), HMSO, London, 1914, paras 93-96.

[13] According to the Chamberlain Commission (para.96), a minimum of 15 million pounds or 50% of the GSR, whichever was higher was to be kept in the form of gold.

[14] IOLR L/F/7/468, F.16 of Colln.43, Kisch's minute dated 22 May 1923. The India Office held this view in the light of the Genoa resolutions. However, the unstable conditions in the financial markets including the precarious position of the sterling in the mid-1920s made the Chamberlain Commission's reserve composition proposals more relevant than ever. But by then, London was willing to allow only

Nor was the gold exchange standard the typical Indian system as is sometimes understood by scholars.[15] It had been evolving into existence for only about 15 years when Keynes characterized it as a complete system rather than one waiting for gold circulation to render it a full gold standard and a currency commission gave it qualified endorsement. Soon afterwards, the war broke out and exposed its fragility. For a time during the war, as silver prices rose, the rupee was effectively on a managed silver standard. When the stabilization of 1920 failed to revive the pre-war gold exchange standard, the rupee was kept on a managed float. However, as Indian reserves were invested predominantly in sterling paper, the Indian currency system met one requirement of an exchange standard - i.e. of using a key currency as a reserve and intervention medium, even when the rupee and the sterling were floating. In 1926 the Hilton-Young Commission proposed a "gold bullion standard" as a compromise between the sterling standard it rejected and a pure gold standard that Indian opinion (including the Government of India) demanded. But as we show in Chapter Five, the gold bullion standard was seen by the India Office and financial circles in London as a piece of fiction which, like the gold standard of thirty years previously, was not meant to be implemented. In the event, despite the objections of the commission, the rupee stayed on a sterling-gold exchange standard.

I.2 BRITAIN AND THE INDIAN GOLD EXCHANGE STANDARD

The traditional view of the gold exchange standard as it operated in India in the first decade and a half of this century and as it was promoted by Britain in the

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nominal amounts of gold in Indian reserves. J.B.Brunyate (recently retired from the India Office) told the Hilton-Young Commission that India would not be allowed to hold gold. See IOLR V/26/302/8, Qn.11458.

[15] League of Nations, **International Currency Experience : Lessons of the Inter-War Period**, Geneva, 1944, pp.29-30.

inter-war period may first be considered briefly. The justification advanced for a global gold exchange standard differs from the benefits postulated for a single country adopting the system.

The arguments used to support an Indian gold exchange standard before 1914 were administrative rather than theoretical. It was contended that Indians did not wish to hold sovereigns which they exchanged for silver rupees in the currency offices. Since the silver for coinage was bought in London, it was needless expense to ship gold back to London to pay for the silver. The purchase of gold or sterling in London against offer of rupees in India would, it was argued, give the Secretary of State the resources to discharge his London obligations (the "Home Charges") and also to buy silver.[16]

It is clear therefore that the gold exchange standard came into operation in India for practical reasons and as a result of the persistence of silver coinage.[17] It was only after the system had been in operation for some years that other reasons were advanced to justify it. It was said that gold in reserves was wasteful and unnecessary and that there were revenue gains in key currency paper.[18] Even this view was not universally accepted. The Chamberlain Commission saw problems in pushing the argument too far. At no time in its brief pre-1913 history was the question of the price impact of the gold exchange standard raised as has been suggested.[19] Keynes dismissed the impact on prices of a gold exchange standard as

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[16] **JMK**, Vol.1, p.75.

[17] **JMK**, Vol.1, p.22.

[18] **JMK**, Vol.1, p.76 puts the revenue gains of India Office "cash balances" which may earn "a small rate of interest" at the end of a list of six administrative benefits. Indian sterling reserves had, at the time of his writing, incurred a capital loss (p.89).

[19] Tomlinson, **Political Economy**, 1979, p.23.

not being "worth considering".[20]

Thus the original aims of the system were different from the justifications that the India Office and scholars used in later years. However, they were advanced in response to Indian criticisms of the gold exchange standard and derived their emphasis in the inter-war years in a global context when British adjustment to its domestic and external disequilibria proved difficult to achieve.

More exceptional was the view that the gold exchange standard, once it came into existence, was a useful way of resisting pressures on British gold reserves. The system, according to this view which found reflection within British financial opinion but was first articulated by the French economist Jacques Rueff, enabled much of the British deficits to be financed by the rest of the world and thus kept the London market liquid. In a famous statement, Jacques Rueff said the system enabled Britain to run "deficits without tears".[21] But the development of this argument in an imperial context owes to de Cecco whose analysis highlights the strain that the United States imposed seasonally on the London gold market and foreshadows some of the trends that dominated financial exchanges during and after the First World War.[22] It may be useful to briefly summarize his analysis.

De Cecco takes issue with the hagiography of the pre-1913 gold standard that had become the norm in inter-war Europe. This is not entirely original. A.I.Bloomifield, P.H.Lindert, A.G.Ford and Robert Triffin had already pointed out the degree of discretion that existed in the pre-1913 gold standard, the role of gold currencies rather than gold in the system and the price that the periphery had to

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20 **JMK**, Vol.1, pp.8-9.

21 A milder version of this statement is in Rueff, J., **Balance of Payments**, New York, 1967, pp.35-36.

22 De Cecco, **Money and Empire**, 1974,pp.62-75.

pay to enable monetary stability at the centre.[23]

De Cecco argues that once the proposal to establish a gold mint in India had been defeated through the exertions of the Treasury, the rapidly growing Indian gold standard reserve was transferred to London in the first quarter of 1902 and invested in British government securities. The British authorities then used the reserve to resist bear pressures on their consols during the Boer War. Thereafter the "management of Indian financial policy passed into the firm grip of the India Office who transformed it into a docile instrument of British monetary policy."[24]

As the Indian trade surplus grew, the need to finance it without losing too much gold from the rest of the world became insistent. India had to absorb between 40 million to 60 million pounds worth of British paper or silver when the Bank of England's gold reserves totalled only about 35 million pounds.[25] Indian surpluses were crucial (as is well known) to British overseas investment. Further, as they were settled in sterling, "... British interest rates (were kept) lower than would otherwise have been the case."[26] Besides reserves held in Treasury bills and longer term paper, the Indian cash balances were placed at call and short notice with City

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[23] A.I.Bloomifield, **Monetary Policy under the International Gold Standard, 1880-1914**, New York, 1959, pp.52-55; **Short-Term Capital Movements under the Pre-1914 Gold Standard**, Princeton, 1963, p.33, p.88. P.H.Lindert, **Key Currencies and Gold, 1900-1913**, Princeton, 1969. A.G.Ford, **The Gold Standard, 1880-1914 : Britain and Argentina**, Oxford, 1962, pp.11-12; "Bank Rate, the British Balance of Payments and the Burdens of Adjustment, 1870-1914", **Oxford Economic Papers**, Vol.16, 1964, p.37. Robert Triffin, "The Myth and Realities of the so-called Gold Standard", in B.Eichengreen, ed., **Gold Standard**, 1985, pp.121-140; **The Evolution of the International Monetary System : Historical Re-appraisal and Future Perspectives**, Princeton, 1964, p.6; see also B.Eichengreen, "Introduction" in B.Eichengreen, ed., **Gold Standard**, 1985, p.18.

[24] De Cecco, **Money and Empire**, 1974, p.70.

[25] De Cecco, **Money and Empire**, p.71. Also see, Ingham, G., **Capitalism Divided? The City and Industry in British Social Development**, London, 1984, pp.125-126.

[26] De Cecco, **Money and Empire**, 1974, p.71.

finance houses. These deposits averaged about 1.15 million pounds though they rose to 3 million pounds in 1910. The sale of council bills exceeded the home requirements of the Secretary of State who also "undersold" them to prevent the export of gold to India. The Bank of England depended "heavily" on the treasury balances of the India Office which tended to increase whenever the India Office made "disproportionate sales of Council Bills".[27] "The reserves ... [of] the Indian monetary system ... provided a large **masse de manoeuvre** which the British monetary authorities could use to supplement their own reserves and to keep London at the centre of the international monetary system."[28]

Indian balances and the manner in which her surpluses were settled were of particular use to London in helping it cope with the strains that the USA imposed upon its money market and upon the system generally. According to de Cecco, the USA was the "largest disrupting factor and India the largest stabilizing factor" in the pre-1913 system.[29]

The financing of American trade was an important source of profit for the London discount market. The American banking system was poorly developed and suffered from a pronounced seasonality in the movement of funds. Funds from the Eastern banks went west to finance harvest procurement but did not return (owing to the their preference for cash to bank deposits) till the Westerners bought imports or Eastern manufactures. Therefore, whenever it lost funds to the west, in the absence of a central bank or a domestic lender of the last resort, New York looked to London to replenish them. In this way there was a greater proportion of gold flowing from London to New York than if the latter market had been able to

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[27] De Cecco, **Money and Empire**, 1974, p.75.

[28] De Cecco, **Money and Empire**, 1974, p.62.

[29] De Cecco, **Money and Empire**, 1974, p.122.

recycle its funds more effectively, and the seasonal cycles of American trade began to be reflected in the British bank rate and in the movement of funds between London and New York.[30] To make matters worse, the US Treasury, the banks and the US public showed phenomenal appetites for gold. The US monetary gold stock increased from $591 million (or 14% of the world's stock) in 1897 to $1891 million (25% of the world's stock) in 1913.[31]

The growth of American surpluses and monetary gold holdings introduced a source of weakness in the Bank of England's control over the gold market. On the other hand, Britain could finance Indian trade to some extent without causing a movement of gold. This enhanced the Bank of England's control over the gold market at any given bank rate and provided the City of London with a comfortable cushion. The City would continue to maintain its leading position in the markets for short-term funds and long-term investment with some aid from India.[32]

Tomlinson disagrees with de Cecco's views on the role of Indian reserves in protecting the liquidity position of the London market.[33] It was neither "accurate nor necessary to regard the gold exchange standard as a device conceived by British financial interests to appropriate India's gold or hamper her economic development."[34] Whatever its consequences, it is no one's view that the gold exchange standard (or any other economic policy in colonial India) was "conceived" explicitly to hamper India's economic development. Nor is it argued that Britain

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[30] De Cecco, **Money and Empire**, 1974, pp.114-17.

[31] M.Friedman and A.J.Schwartz, **A Monetary History of the United States, 1867-1960**, Princeton, 1963, pp.137-138.

[32] De Cecco, **Money and Empire**, 1974, pp.120-121.

[33] Tomlinson, "India", **IESHR**, 1975, p.369 concedes that the Empire was used to protect the sterling but he does not develop this insight. In general he steers clear of India's role in protecting British interests in the world financial system.

[34] Tomlinson, **Political Economy**, 1979, p.23.

aimed to appropriate "India's gold" in pursuit of some mercantilist ambition. As pointed out earlier, the gold exchange standard evolved almost accidentally from the persistence of token silver coinage and thereafter the Treasury, London financial interests and the India Office began to see the advantages for London that the system offered.

Tomlinson is critical of de Cecco's analysis on two empirical grounds. He suggests that Indian reserves, because of their small size in relation to the British government's sterling liabilities, did not help keep London interest rates down.[35] Secondly, he argues that the India Office lent funds to the Bank of England to keep interest rates high.

India Office dealings with the Bank of England were not the only call or short-term investments it made in the London market. The India Office lent its balances also to finance houses in the City but made loans to the Bank when the latter desired a tightening of monetary conditions in London. In other words, under normal monetary conditions, the India Office's placement of funds with City finance houses eased the London market. Recognising this, the Bank of England sought India Office advances in times when it wanted to tighten credit conditions. Further it could be argued that India Office loans to the Bank of England enabled the latter to achieve given monetary targets with a smaller increase in the Bank rate than would have been necessitated in the absence of these loans. Hence, the bank's use of Indian funds to tighten the market does not indicate that at other times Indian funds did not ease the market.[36]

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[35] Tomlinson, **Political Economy**, 1979, p.22.

[36] See Cambridge South Asia Archives, **Benthall Papers** XX, F.1, "Note on the Evidence of Felix Schuster to the Chamberlain Commission". Schuster - a joint stock banker - admitted that India Office lending was a "considerable advantage" to the London market because it reduced interest rates. Also see **JMK**, Vol.15, p.89 where Keynes makes a similar point.

Similarly, the size of India's sterling holding in relation to total sterling liabilities does not sufficiently describe its role in easing the London market under normal trading conditions. Indian reserves might have worked on the margin to produce changes in monetary indicators in the directions they did.[37]

There are really two points involved here and it may useful to separate them. The first one relates to the margins around which exchange market interventions take place. We will return to this point with a historical example presently. The second point concerns the confusion that arises from a failure to distinguish between India's absorption of sterling paper in its reserves and the reduced demand for gold arising from this and from India's persistence with silver coinage. Indian reserves had two distinct effects on London's liquidity position. Analytically each was the counterpart of the other but the effect on the London market was two-fold. Firstly, by holding sterling reserves India avoided a draft on monetary gold which it released to settle other demands for gold in London. Secondly, her reserves replenished liquidity in London. It may be useful to highlight the distinction by considering the two relevant counterfactuals.

Suppose India had been on a pure silver standard. India would not have set up a demand for monetary gold - **ceteris paribus** - as the Indian surpluses would have been settled in the form of silver. So in its effects on the world's monetary gold stocks, a silver standard in India would have been similar to a gold exchange

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[37] But Indian official sterling holdings ($136 million in 1913) were large in relation to total official sterling holdings ($431 million) and larger than the holdings of any other country. See P.H.Lindert, **Key Currencies**, 1969, Table 2, pp.18-19. On the contribution of Empire sterling holdings to sterling stability, see PRO T160 480/F12600/011/3, Treasury to Rowe-Dutton, letter dated 3 November 1932 which said a bear attack on the sterling would not be to the full extent of overseas sterling obligations because of the Empire's sterling reserves. This expectation would have been much stronger for earlier periods. Also see Churchill College Archives(CCA), Hawtrey Papers, Htry 1/47, "Bank Rate and the Crisis", memorandum dated 1 August 1931.

standard. But since silver would have now circulated as full-bodied rather than token coin, there would have been no profits from silver coinage to invest as the gold standard reserve. To the extent that these profits - the rupee parity remaining the same - went to silver producers (in the USA), Britain, despite the gold economy achieved, would have faced some loss of liquid resources.

Suppose instead that India had had a "pure" gold standard. London would have faced monetary gold drains to India and the disappearance of the bulk of the investments in the gold standard reserve.

The gold exchange standard in India however allowed a token silver coin for a currency on a gold peg. Therefore it had the same effect on London gold resources as a silver standard (in averting gold losses) but it also had an advantage over the silver standard in that it generated coinage profits which were invested in sterling paper. In other words, as a result of the Indian gold exchange standard, not only did Britain prevent monetary gold losses but also it secured a capital inflow whose size depended on the cost of currency in India.

Since this was so, it could be argued that Indian reserves eased London's liquidity position rather more than its share in British government liabilities would indicate. However, in what follows, we show from a study of archival sources that India's investments, regardless of their size, were perceived to ease the markets in the 1906-08 crisis.

In January 1906, the India Office preferred to invest half a million pounds (from the profits of silver coinage) in sterling securities to acquiring gold which "could not be set aside without disturbing the London market ...."[38] Later the same year

[38] IOLR, L/F/5/4, F.3896, minute by Abrahams dated 29 January 1906.

when the Government of India wanted gold earmarked for the Paper Currency Reserve in London, Abrahams of the India Office said that "withdrawal of gold from the free resources of the Bank of England ... (was a) ... serious measure. ... A large withdrawal of gold by us would of course make a rise (in the bank rate) very much more probable, and would at any rate militate against the chance of an early reduction." It would cause ill-feeling against the India Office, worsen the terms of future debenture renewals, render new issues more difficult and affect the stability of City firms with whom the India Office had cash at short notice.[39] This explanation did not convince the Government of India who said India Office made loans "exclusively in the interest of the City" and that the price of the City's goodwill seemed too high.[40]

In May 1907 the American crisis produced severe stringency in the London money market as the bank rate rose to 6 per cent. At this time the Indian reserves were a source of funds which the Treasury used to reduce strains in the market. A Treasury official asked Lionel Abrahams whether the India Office could invest in Irish land stock which the Treasury wanted to sell but whose issue to the public it sought to avoid, at "so ruinous a price".[41] The India Office disclosed that it could invest 1.5 million pounds over the following year, ideally in short-dated paper. Abrahams asked the Treasury to arrange for him to take over short-term securities

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[39] IOLR L/F/5/29, p.517, Abrahams to Meston, letter dated 26 October 1906. See also para.3 of Financial Despatch no.3 dated 26 April 1907; S.Ambirajan, **Political Economy**, 1984,p.169; L.S.Presnell, "Sterling System and Financial Crises before 1914", in C.P.Kindleberger and J.P.Lafargue, eds., **Financial Crises : Theory, History and Policy**, Cambridge, 1981, p.162. On the effect of Indian gold arrivals on London interest rates, see H.W.Badock's note of 22 July 1905 in the above file. He said rumours of a 5 million pound gold shipment from India depressed interest rates in London.

[40] IOLR L/F/5/4, Baker to Abrahams, letter dated 21 February 1907. India Office investment decisions in the 1906-1908 crisis supported Blackett's belief that in an emergency, the Bank of England could draw upon Indian reserves. See PRO T170/14, "Gold Reserves", Blackett's memorandum dated 22 May 1914.

[41] IOLR L/F/5/4, Hamilton to Abrahams, letter dated 7 May 1907.

from other government departments so that they could invest in Irish land stock.[42] After meetings with the National Debt Office, Abrahams minuted that the former felt it would be a "great assistance" if the India Office could take over securities worth 1 million pounds before the end of June. Six hundred thousand pounds were invested in Exchequer bonds maturing in October 1909.[43]

Despite the London market's dependence (to some extent) on Indian funds to ease monetary conditions even before 1914 and evidence that Indian investments may have been timed accordingly, in theory it would be hard to fault the gold exchange standard. In practice too, before the war, there is no evidence of any damage to Indian financial interests arising from it, apart from losses sustained on India's sterling investments, and perhaps the premature transfer of funds from India to London. The latter was part of the learning process and its monetary impact could have been cushioned quite easily through lending from reserves or cash balances.

But a key to the system's success for a subsidiary-currency country lay in the degree to which the latter could exercise the freedom of portfolio choice and control over exchange rate policy within certain rules. As long as the centre country and the reserve currency user were in a state of relative equilibrium - as in the years before 1914 - this would not matter. But once there is a departure from equilibrium, more specifically when the centre country faces a liquidity crisis, its effective control over financial policy on the periphery enables it to derive benefits (and impose costs on the latter) that would not have been possible in a normal (non-political) gold exchange standard relationship. In the inter-war years, India's dependent financial position enabled Britain to subject her to some of its

42 IOLR L/F/5/4, Abrahams to Hamilton, letter dated 9 May 1907.

43 IOLR L/F/5/4, F.3896, "Investment on account of the Gold Standard Reserve", minute by L.Abrahams dated 23 May 1907 and Abrahams to Harvey, letter dated 25 May 1907.

own adjustment burdens. Now we proceed to an overview of policy and environment during the First World War and during the inter-war period.

I.3 THE GOLD EXCHANGE STANDARD IN WORLD WAR I

The advantage that the British authorities derived from their ability to affect the composition of Indian reserves increased greatly during and after the First World War. The concern, already emerging in the pre-1913 gold standard, that India should not set up a monetary demand for gold was heightened in this period.

During the war, Britain ran a trade deficit with India. Her import gap with the USA also widened and was larger than could be financed through credits in that market. This chiefly accounted for the embargo on gold movements to India. With the exception of Japanese exports and small Indian government purchases, the checks applied both to non-monetary and monetary gold. As silver procurement was also delayed, most currency expansion in India took place against British Treasury bills in the Paper Currency Reserve. At one stage during the war, the metal holding in the reserve fell to as low as 35% with gold accounting for about a tenth of the whole reserve (Table **II.1** below). By the end of the war, practically the whole of the Gold Standard Reserve had also been placed in sterling paper. The war was an exceptional situation but, analytically, it gave rise to a substitution and then an adjustment of the first class liquidity demands of the periphery, as the centre itself began to face a liquidity shortage. This aspect is examined in greater detail in the next two chapters.

Even after the war was over, fears that the demand for currency would threaten its

1919 minute drove the Treasury to seek gold from the Indian reserves.[44] Treasury officials expressed a wish to purchase or borrow some Indian gold and suggested a figure of 5 million pounds. The India Office replied that much as it would have liked to help, problems peculiar to India made it impossible. The Government of India was selling gold in India to check the fall in the rupee and meeting the Treasury request, the India Office said, would leave Delhi with no option but to sell reverse councils at a loss. It was also impossible to deplete the gold holding in the Paper Currency Reserve by more than projected gold sales in India. It asked the Treasury to buy gold from the Indian government by bidding for it in Bombay. According to an India Office minute which summarized discussions that its officials had with the Treasury, the former "emphasized the difficulty that there could be ... in justifying transactions of the above kind from an Indian point of view, especially at the present time, when (questions of) currency are receiving close attention from Indian politicians."[45] In reply, Niemeyer sent a modified proposal and told the India Office that even after the gold sales programme of the Government of India concluded in August 1920, it would have substantial holdings of the metal which it could profitably sell at current prices. He suggested that the India Office justify the sale to its critics as a "business deal for India".[46] The India Office reiterated that political problems in India ruled out the deal.[47]

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[44] S.K.Howson, **Domestic Monetary Management in Britain, 1919-1939**, Cambridge 1975, p.14 and "Origins of Dear Money, 1919-1920", **EHR**, Vol.27, No.1, 1974, pp.88-107.

[45] PRO T160/F.571, Howard's minute written in July 1920. For the background in which Indian objections were feared, see chapter **III.3**.

[46] PRO T160/F.571, Niemeyer to Kisch letter dated 10 July 1920. Niemeyer's revised proposals are in Niemeyer to Governor of the Bank of England, letter dated 10 July 1920 in the above file. The India Office sold some gold in 1923 and justified it as a "business deal". Niemeyer's suggestion on how the gold sale could be defended might suggest that, in some cases, the real aims of policy might have been quite different from the declared ones.

[47] PRO T160/F.571, Kisch to Niemeyer, letter dated 15 July 1920. Again in February 1921 the Treasury asked to buy some Indian gold to repay debts to the USA. See PRO T160/78 F.2732, Blackett to Kisch, letter dated 10 February 1921.

Till the 1930s Britain continued to be dogged by liquidity constraints which made the size of gold movements to India a matter of some importance to her. To understand why this was so it is necessary to discuss briefly the role of gold in the pre-1913 financial system and the inter-war system as it affects us.

I.4 THE ROLE OF GOLD

The payments system that existed in much of the trading world till 1914 is usually characterized as a "pure" gold standard. Traditionally, this has been understood as a system in which national currencies were pegged to gold at a fixed ratio and regardless of whether active gold circulation existed in the domestic economy, gold movements restored domestic and external equilibrium. The so-called "price-specie flow mechanism", in terms of which inflation-prone countries or countries suffering an external imbalance lost gold and thus restored their external equilibrium and equalized domestic and world prices, has for long been the favourite text-book model of gold standard adjustment.

Scholars have not only been sceptical of this model but also, more recent empirical research has suggested that the above picture was too simple to be historically accurate. The inaccuracies concern two aspects primarily : the importance of gold in the system and the relative roles of gold and deposit movements in creasing away disequilibria.[48]

Lindert argues that the role of gold in the pre-1913 system has been exaggerated.

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[48] The theoretical re-examination of the gold standard adjustment process relates largely to a discussion of the variables that adjust to a given stimuli. The discussion would exist regardless of whether the stimuli was in the form of gold losses or deposit losses. The choice of the preferred adjustment variable depends on the model which is being used.

According to him, between 1900 and 1913, the gold standard had already moved towards a key-currency system, with central banks investing their reserves in key-currencies rather than in gold. The pound sterling, the French franc and the German mark were the main reserve currencies in the period. Official holdings of foreign-exchange assets increased, according to Lindert's estimates, from $246.6 million in 1899 to $1124.7 million by the end of 1913.[49] In this period the official holdings of key currency assets grew much faster than the corresponding holdings of gold.[50]

Sterling was the most important reserve currency. It accounted for almost 40% of all official reserve currency holdings in 1913.[51] The franc came next with some 25%, almost 80% of which was held by the Russian government. The mark was also a popular reserve currency especially among the European countries (excepting Britain and France) among whom holdings in marks seem to have been more popular than those in sterling or (except for Russia) those in francs. Nevertheless for the world as a whole, official sterling holdings more than exceeded official franc and mark holdings taken together.[52]

The sterling was also the most important transaction medium in international trade,

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[49] Lindert, **Key Currencies**, 1969, p.22.

[50] Lindert, **Key Currencies**, 1969, pp.25-26. J.Foreman-Peck and R.Michie, "The Performance of the Nineteenth Century Gold Standard" in Wolfram Fischer, R.Marvin McInnis and Jurgen Schneider, eds., **The Emergence of a World Economy, 1500-1914**, Papers of the IX International Congress of Economic History, International Economic History Association, Wiesbaden, 1986, Part II, 1850-1914, pp.388-391 say that "the term international gold standard was a misnomer long before the system was abandoned .... It was not the transfer of gold or the exchange of goods and commodities that underlay the smooth operation of the international gold standard before 1914 but asset arbitrage involving securities and finance bills." (p.389). Also see J.Foreman-Peck, **A History of the World Economy : International Economic Relations since 1850**, Brighton, 1983, pp.168-170.

[51] Lindert, **Key Currencies**, 1969, p.22.

[52] Lindert, **Key Currencies**, 1969, pp.18-19.

although the dollar played a similar role within North America, as did the franc and the mark on the continent. Foreman-Peck and Michie point out that bills drawn on London increased from an average of 600 million pounds in 1876/1880 to 1100 million pounds in 1911/1913. Though world trade grew faster than the volume of sterling bills, a large proportion of international transactions was denominated in sterling. Similarly, investments in London in the form of government paper, corporate stock or bank deposits were an important feature of the deployment of private funds in the pre-1914 system. Between 1892 and 1908 the size of bank funds in London belonging to foreign and colonial banks with head offices or branches in London rose from 370 million pounds to 952 million pounds or from 32% to 47% of such funds.[53] But even in this respect, London was not alone. Paris, New York and Berlin played similar roles to a varying extent.

Although not unique, sterling was still at the top of a hierarchy of reserve currencies. Of particular interest to us is the fact that since this was so, funds moved out of the subsidiary reserve currencies like the mark and the franc whenever there was monetary stringency in London and even when interest rate differentials between the countries concerned remained unchanged. The subsidiary reserve centres, in turn, drew in funds from their own peripheries.[54] The asymmetry in the direction in which funds moved in response to the same change in interest rates (leaving interest rate differentials unchanged) is explained by the fact that in periods of monetary tightness funds were moved to more liquid centres and into more liquid assets.[55] The tendency to regard sterling assets as being more liquid even though the Bank of France suffered from a smaller franc overhang than the Bank of England and the German **Reichbank** suffered a sterling overhang or a

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[53] Foreman-Peck and Michie, "Performance" in W.Fischer et al eds., **Emergence**, 1986, p.390-391.

[54] Lindert, **Key Currencies**, 1969, pp.48-52.

[55] Lindert, **Key Currencies**, 1969, pp.55-56.

mark overhang respectively, may not have related to each country's net short-term debtor position. More important in the British case was London's role as the market for the primary reserve, namely gold. For this reason, the possession of sterling assets was regarded as the surest means of securing gold when required.[56] As important might have been the expectation that the centres from which London drew funds during periods of monetary tightness were many more than those from which Paris or Berlin could hope to attract funds. The response of non-sterling asset-holders may have rendered this expectation a self-fulfilling one. The close political relationship between Britain and the governments of some countries which held sterling paper would also have reassured investors that the risks of sterling holding would not necessarily rise in proportion to the volume of sterling liabilities.

The war ended the pre-war gold standard though some scholars such as de Cecco argue that even otherwise, the system was set for a collapse because of the declining power of London and the sterling.[57] In any case, the system was moving towards radical change which the war did much to accentuate.

The tremendous inflation stoked by the manner in which the war expenditures had been financed and the differential rates of inflation between the USA on the one hand and the countries of Europe on the other meant that pre-war parities had ceased to be viable. The delayed adjustment of prices in Europe after the war ended pointed to the permanent disability of the major currencies to return to their pre-war alignments. The large war debt and reparations overhang and speculative capital movements, if any thing, made realistic post-war exchange rates more necessary than ever.

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[56] Lindert, **Key Currencies**, 1969, p.34.

[57] De Cecco, **Money and Empire**, 1974, pp.127-128.

But important financial and political circles in Britain were committed to returning the sterling to gold at the pre-war parity. They saw this as the only lasting cure for Britain's post-war unemployment problem. They also felt that the step was essential to preserving the monetary unity of the Empire and sustaining London's pre-eminence in the world financial system.[58] But as Keynes wrote to Addis, pre-war recipes were no longer sufficient to ease the British liquidity position.[59] This was said with good reason because of the transformation in the relative financial strength of New York and London after the war.

The war changed the role of the United States from a major debtor to that of being a major creditor. It reduced Britain's overseas investments substantially and she came out of the war indebted to the USA to the tune of about 5 billion pounds. With falling current account surpluses and rising domestic capital needs, Britain ceased to lend abroad as extensively as she did before the war.[60] New York in turn did not emerge as an important market for loans till the middle of the 1920s. Together with uncertain conditions in the world financial markets, the absence of

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58 See D.E. Moggridge, **The Return to Gold, 1925 : The Formulation of Policy and its Critics**, Cambridge, 1969; S.K.Howson, **Domestic Monetary Management**, 1975 and S.S.Pollard, ed., **The Gold Standard and Employment Policies between the Wars**, London, 1970, "Introduction", pp.1-26 and W.A.Brown Jr., "The Conflict of Opinion and Economic Interest in England", pp.44-46; for an understanding of the US role in ensuring Britain's return to gold, see, F.C.Costigliola, "Anglo-American Financial Rivalry in the 1920s", **Journal of Economic History (JEH)**, Vol.37, No.4, 1977, pp.911-934 and Marcello de Cecco, "The International Debt Problem in the Inter-War Period", **Banca Nazionale de Lavoro Quarterly Review (BNDLQR)**, No.152, 1985, pp.49-64.

59 SOAS, Addis Papers, PP.Ms.14/407, letter to Addis dated 25 July 1924. Also see PRO T175/125, Keynes to Hopkins letter dated 19 April 1928. "The more I think about it, the more I am impressed with the extreme rashness and folly of carrying on an international banking business in these days of large figures, when we are no longer the only international centre, with a free gold reserve not only of a trifling magnitude in itself, but a very small fraction of the free reserves of the rival financial centre, the United States." The return to gold represented a failure of the imagination : see S.Glynn and A.Booth, "Unemployment in Inter-War Britain : A Case for Re-Learning the Lessons of the 1930s?", **EHR**, Vol.36, No.3, 1983, p.341.

60 D.E.Moggridge, **British Monetary Policy, 1924-1931 : The Norman Conquest of $4.86**, Cambridge, 1972, p.33.

desirable long-term assets meant that short-term securities became the main instruments of saving. According to one estimate, some 2 billion pounds of these potentially volatile funds were floating around in the 1920s.[61] These flows were disequilibrating rather than equilibrating and necessitated increasing national liquidity requirements.[62]

Secondly, as we have already explained, before the war London had been at the head of a hierarchy of financial centres and in a position to draw funds from other centres whenever a tightening of the market was indicated. Berlin's role as a financial centre had all but been destroyed in the war. The political instability that followed it and the hyper-inflation of 1923 further diminished its standing. With the withdrawal of Russia from active participation in the world's financial system, Paris' role also underwent a change. The latter however was to have some important consequences for the course of stabilization operations in Europe in the 1920s and an uneasy influence on the stability of the sterling's link to gold over 1928-1931. The collapse of the financial centres whose funds responded to changes in the London bank rate was compounded by the emergence of New York which was far less sensitive. Together they reduced the funds that London could hope to draw upon in a crisis.[63]

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[61] J.Foreman-Peck, **A History**, 1983, p.236 and **Report of the Committee on FinanceandIndustry**(MacmillanCommittee),Cmd.3897,HMSO,London,1931,para.153.

[62] League of Nations, **International Currency**, 1944, p.29; Report of the Macmillan Committee, 1931, paras.351-352.

[63] D.E.Moggridge, **British Monetary Policy**, 1972, p.221. A.Cairncross and B.Eichengreen, **Sterling in Decline : The Devaluations of 1931, 1949 and 1967**, Oxford, 1983, pp.37-49, point out that the ineffectual bank rate involved the Bank of England in a constant battle against a gold drain and bear pressures on the sterling. In the restored gold standard, sterling was below par in 60 out of 76 months. Over 1888-1914, this had happened only in 4 months (p.37). W.A.Brown Jr., **The International Gold Standard Reinterpreted, 1914-1934**, Vol.1, New York, 1940, pp.133-156 speaks of the weakening of the "basic pull" of London over the exchanges of the world. Further the bank rate in the 1920s operated more by increasing London's short liabilities than by calling in short assets.

Till the mid-1920s, New York and London were left as the two major centres in the international financial system. The sterling was on a managed float from March 1919 till April 1925 while the dollar remained pegged to gold at the pre-war parity. As we have pointed out earlier, Britain was running higher rates of inflation than the USA and the sterling's return to a pre-determined par was bound to be a struggle. Even before returning to gold in 1925, Britain was in "fundamental disequilibrium".[64]

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[64] The term owes to Art.iv.5(a), "Articles of Agreement of the International Monetary Fund". See **JMK**, Vol.26,p.402. It represented a serious disequilibrium requiring an exchange rate change rather than one that could be corrected through fiscal or credit policy.

I.5 BRITAIN AND THE GOLD EXCHANGE STANDARD

The exchange rate could not be used to adjust the disequilibrium since the objective of returning to gold at the pre-war parity meant that the sterling could only move up in the medium and long-term. Therefore a greater part of the adjustment burden was thrown on the domestic economy and the process was beset with difficulties.

The necessary adjustments could have been accomplished equally well had the United States led the world by inflating its economy. In fact this was Britain's preferred adjustment scenario which she tried to accelerate by exporting as much gold as possible to America.[65] As US gold receipts eased monetary conditions in New York, it was expected that monetary conditions in London too would be eased.[66] This strategy necessitated that London be able to control gold movements and direct its flow as necessary. It was a measure of the success achieved that between April 1920 and December 1925, there were only three months in which USA was a net exporter of gold.[67]

But the USA was reluctant to inflate till 1924 and she sterilized her large gold imports through open market operations. Monetary sterilization only increased American gold imports without an appreciable effect on prices and interest rates.[68]

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65 Moggridge, **Return to Gold**, 1969, p.46 and pp.81-87.

66 To London's disappointment, neither the timing nor size of American expansion coincided with British needs. Making things worse was the asymmetry in the movement of funds between London and New York. See Eichengreen B., "International Policy Coordination in Historical Perspective : A View from the Inter-War Years", in Buiter, W. and Marston, R., eds., **The International Coordination of Economic Policies**, Cambridge, 1985, p.146 and E.Harvey to Macmillan Committee, Qn.7515, **Proceedings** of the Committee, 1931.

67 W.A.Brown Jr., **England and the New Gold Standard, 1919-1926**, New Haven, 1929, p.29.

68 Friedman and Schwartz, **Monetary History**, 1963, pp.284-285.

Therefore, Britain had either to carry her own burden of adjustment or trigger world expansion as best as she could. The reconstruction of the war-damaged economies of Europe and setting on their feet the new countries that emerged out of the war provided avenues for expansion. The situation of financial collapse that existed in Europe at the end of the war also provided Britain with an opportunity to exercise financial leadership on the continent.

Britain's ability to trigger world expansion on her own by reducing domestic interest rates and expanding overseas lending was hampered by the prospect of gold losses which would threaten the longer-term objective of returning sterling to gold at the pre-war parity.[69] She could contribute independently towards global expansion only in a system in which sterling outflows did not automatically lead to a demand for gold. In order to create such a system, Britain began urging central banks to hold securities in their reserves rather than gold. The stabilization of the Central European economies in the first half of the 1920s gave Britain the chance to put this ideal into practice. The countries in whose stabilization she was involved (including Austria, Czechoslovakia and Hungary) largely held sterling in their reserves.[70]

In other words, Britain was forced to formally seek the constitution of a system similar to the one that had arisen spontaneously before the war. In the Genoa Conference of 1922 she sought agreement on the establishment of a gold exchange

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69 CCA, Hawtrey Papers 1/13, "The Rediscount Rate of the Federal Reserve System", and S.K.Howson, **Domestic Monetary Management**, 1975, p.27.

70 Costigliola, "Anglo-American", JEH, 1977, p.919. He points out that as long as Britain put only the smaller European countries on sterling, the USA was indifferent. But once she tried to pull Germany into the sterling area, USA intervened to get the Germans to link to gold. Also see W.A.Brown Jr., "The Conflict" in S.S.Pollard ed., **Gold Standard**, 1969, p.61 and J.Kooker, "French Financial Diplomacy : The Inter-War Years" in B.Rowlands ed., **Balance of Power or Hegemony : The Inter-war Monetary System**, New York, 1976, pp.86-88.

standard.

The British aim in the Genoa Conference was to launch a "two part effort to integrate ... Europe into a commercial and financial community led by London."[71] The first part of the programme (which soon became irrelevant) aimed to revive trade between the Soviet Union and the rest of Europe by means of a closed-door consortium under British leadership. The second and more lasting part of the programme was to encourage the adoption of the gold exchange standard by the nations of Europe and persuade them to hold the bulk of their reserves in foreign securities.

Though the dollar and the sterling were cited as the two reserve currencies, Britain might have hoped that London's traditional role as an international banker would bring to London the lion's share of the reserves of the gold exchange standard countries.[72] The increased use of sterling as a reserve currency was seen to possess several advantages. It would reduce the demand for new gold and enable a larger part of it to be channelled towards the USA as Britain sought in this period. The gold exchange standard would prevent British and European deflation by enabling expansion to be backed by foreign currency reserves and ensuring that expansion did not slacken because of a primary reserve shortage. If there was coordinated progress towards the goal, stop-go policies, especially in Britain, could be abandoned as global expansion took care of secondary reserve (specifically sterling) surpluses as well. Britain would then be enabled to run larger payments

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71 "Anglo-American", **JEH**, 1977, p.917.

72 Costigliola, "Anglo-American", **JEH**, 1977, p.917; de Cecco, "International Debt", **BNDLQR**, 1985, p.50; Robert Triffin, **Evolution**, 1964, pp.22-23; L.S.Pressnel, "1925 : The Burden of the Sterling", **EHR**, Vol.31, No.1, 1978, p.72; B.Eichengreen, "International Policy", in W.Buiter and R.Marston eds., **International Coordination**, 1985, p.149.

deficits than she would have otherwise been able to.[73] As these processes merged it would be possible for sterling to return to gold speedily and without excessive deflation.[74] The logic of her interests therefore made the gold exchange standard a compelling necessity for Britain.

We have seen earlier that the pre-1913 system was evolving towards a gold exchange standard. As Lindert points out, the composition of reserves in the pre-war years and the mid-1920s were so similar as to undermine the frequent distinction between a gold standard and a gold exchange standard.[75] The distinction between the pre-1913 and the inter-war system therefore lay less in the extent to which use was made of reserve currencies and more in the extent to which sterling was spontaneously acceptable as a reserve currency. "Sterling was perhaps not as good as gold."[76]

There were two important reasons why access to gold was more important for Britain in the inter-war period than in the pre-war one. Firstly, Britain hoped to

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[73] Britain was only trying to extend to Europe, a system she had adopted in India and the other colonies before 1913. As Triffin points out, surpluses and deficits with the Empire merely led to a reshuffling of British bank deposits, rather than to an overall expansion or contraction in their amount and to gold inflows and outflows. See Triffin, "Myths and Realities" in B.Eichengreen ed.,**Gold Standard**, 1985, p.125.

[74] Costigliola, "Anglo-American", **JEH**, 1977, pp.917-918.

[75] **Key Currencies**, 1969, p.76.

[76] J.Foreman-Peck, **A History**, 1983, p.236. The British attempt to encourage the use of sterling in official reserves was not unsuccessful though their distribution reduced the desirable liability-to-asset profile of the Bank of England. Official gold reserves doubled over 1913-1929 ($4.9 billion to $10 billion) largely because of reduction in non-monetary gold holdings. But Central Bank holdings of sterling increased from the equivalent of $700 million in 1913 to the equivalent of $2.5 billion in 1928 (R.Triffin, **Evolution**, 1964 p.65, p.22). Out of this, according to the League of Nations, (**International Currency**, 1944, Appendix I, p.233) some $800 million represented sterling area holdings. B.Eichengreen, "International Policy", in W.Buiter and R.Marston eds. **International Coordination**, 1985, p.145 estimates that the Bank of France's liquid sterling assets in 1928 roughly equalled the Bank of England's entire gold reserve of about $800 million.

increase its dollar earnings by exporting gold to the USA. Secondly, whereas before 1913, the fundamental price equilibria were in place and gold was needed only **in extremis** to avert bear pressures on the sterling arising from temporary disturbances, post-1919, gold was needed to secure sterling's return to par through an inflationary adjustment of world prices and for meeting the movement of speculative short-term funds. But London's need to find gold specific uses and channelize it into the reserves of particular countries (notably the USA) arose precisely at a time when uncertain conditions in the world's financial markets made gold holding - in the absence of effective policy coordination - more rather than less rational for monetary authorities.[77]

In this situation, Britain began to perceive a gold shortage and quite clearly, Britain's espousal of a gold exchange standard arose as a result of this perception. Though often the two were confused, there were actually two distinct problems here. The first long-term problem arose from the prospect that world gold supply would grow slower than the growth in world trade, thereby slowing down the latter. Eventually, something like a gold exchange standard would have had to evolve to avoid world liquidity shortages. The second problem was a short-term one. It arose from what Britain perceived in the early and mid-1920s as the mal-distribution of monetary gold in favour of the USA and by the end of that decade in favour of USA and France.[78] The short-term gold shortage problem that dominated the 1922

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[77] B.Eichengreen, "Central Bank Cooperation under the Inter-War Gold Standard", **Explorations in Economic History (EEH)**, Vol.12, No.1, January 1984, pp.64-87; J.Foreman-Peck and R.Michie, "Performance", in W.Fischer et al eds., **Emergence**, 1986, p.390; League of Nations, **International Currency**, 1944, p.44.

[78] The distribution of monetary gold changed sharply in the US' favour between 1913 and 1923. US overseas lending which expanded from 1924 till 1928 partially reversed the trend. In 1913, USA had 29% of the world's monetary gold stock of $4435 million and Britain held 3.7%. The corresponding proportions in 1918 out of a monetary gold stock of $6816 million were 39% and 7.6% respectively, 44% and 8.6% in 1923 out of $8651 million and 37.2% and 7.5% out of $10057 million in 1929. Source: League of Nations, **International Currency**, 1944, Table 2, p.240.

The British share of global monetary gold stock grew faster than the American share. The Macmillan Committee (para 153) felt however that the large size of

Genoa discussions was just another way of representing Britain's liquidity problems which arose from the fact that her current account surplus was not large enough to support domestic reconstruction as well as enable Britain to lend abroad. This problem was somewhat identical to the one that presented itself as a dollar shortage to Britain after the Second World War and it made a large scale adoption of the gold exchange standard a more urgent necessity for Britain than it was for countries which had healthier current accounts or fewer financial ambitions. However, the fact that the United States refused to have anything to do with the proposal indicated that her view of inter-war financial problems differed from that of Britain.[79]

But a gold exchange standard that made world reserve availability a function of the deficits of a key-currency country is inherently unstable and in the background of the collapse of the Bretton-Woods designed gold exchange standard, there has been

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liquid sterling claims (the holding of which, it said, was akin to hoarding) made even Britain's enhanced reserves inadequate. Also, the distribution of gold between USA and Europe was still a serious problem. According to the Report, in 1913 Europe held 63% of monetary gold. In 1925 she held only 35%. See Report of the Macmillan Committee, 1931, paras.140-143.

[79] The decline of a key currency country has always led it to advance proposals for financial innovation. In 1922 the USA rejected the British idea of a gold exchange standard and refused to participate in a central bankers' conference on it unless she got one vote more than the other countries combined. Costigliola, "Anglo-American", **JEH**, 1977 p.919. But in 1944, the USA accepted the gold exchange standard, with the dollar as the main reserve asset partly to defeat a radical British proposal to augment world liquidity through multilateral reserve creation. For a study of the Bretton-Woods negotiations, see R.N. Gardner, **Sterling-Dollar Diplomacy**, New York, 1969, Van Dormael, A., **Bretton Woods : Birth of a Monetary System**, London, 1978 and Marcello de Cecco, "Origins of the Post-War Payments System", **Cambridge Journal of Economics**, Vol.3, No.1, 1979, pp.49-62. In the early 1960s the sterling found its secondary reserve asset role hard to support. Britain suggested the creation of a mutual currency account so that, in the words of its Finance Minister, "world liquidity (may) be expanded without additional strain on reserve currencies"; quoted in R.Solomon, **The International Monetary System : The Insider's View**, Harper and Row, New York, 1977, p.63. The US rejected the British initiative and asserted that the dollar needed no such support. But six years later the USA accepted the need for a reserve asset that was not linked to US deficits and finally acquiesced in the creation of Special Drawing Rights (SDRs).

a crop of literature to explain the instability.[80]

Further, in the circumstances of the 1920s, even ignoring the political and monetary

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[80] The first such model was historical and based on the collapse of the sterling in 1931. See R.Triffin, **Gold and the Dollar Crisis**, New Haven,1960, pp.8-10. P.B.Kenen, "International Liquidity and the Balance of Payments of a Key-Currency Country", **Quarterly Journal of Economics**, Vol.74, No.4, 1960, pp.572-586 developed a formal model of Triffin's instability hypothesis and suggested that a gold exchange standard would collapse if the rate of desired reserve growth was too high or the rate of growth of monetary gold reserves, too low.

M.L.Greene, "Reserve Asset Preferences Revisited", in P.B.Kenen and R.Lawrence eds., **The Open Economy : Essays on International Trade and Finance**, Columbia, 1968, pp.353-385 offers a model of strategic central bank restraint stabilizing the system. But Greene ignored private portfolio behaviour. Central banks may not behave with strategic restraint when private asset-switching increased the system's unpredictability and collapse is widely expected. There are also models of systemic stability which argue that given a distribution of responsibilities in the global monetary system, no system need be fatally unstable. See for example R.A.Mundell, "The Crisis Problem", in R.A.Mundell and A.K.Swoboda eds., **Monetary Problems of the International Economy**, Chicago, 1969, pp.343-350 and **International Economics**, London, 1968,pp.282-286, J.Niehans, **The Theory of Money**, Baltimore, 1978, p.158 and H.G.Johnson, "The Bretton-Woods System, Key Currencies and the Dollar Crisis of 1971", **Three Banks Review**, No.94, June 1972, pp.3-22. In general, these models suggest that for each equilibrium in price space, there was an equilibrium point in reserve space and if one set of countries (the key-currency users) preserved equilibrium reserve positions and the key currency country preserved equilibrium price levels, the system need not be unstable.

However, as Marina von Neumann Whitman points out, this distribution of adjustment responsibilities involved a virtual neglect by key currency users of an active stabilization policy. See M.v.N.Whitman, "Comment" on R.A.Mundell in Mundell and Swoboda eds., **Monetary Problems**, 1969, pp.351-356.

The objectives of central bank coordination, at least in British eyes, were similar to the models of systemic stability described above. See Montagu Norman to Macmillan Committee, **Proceedings**, 1931, Qn.3490. Keynes asked Norman if the object of international cooperation was to relieve the struggle for gold. Norman agreed and said the objects were to pursue a "common monetary policy, and do away with the struggle for gold." On the ineffectiveness of central bank policy coordination in this period, see B.Eichengreen, "Central Banking", **EEH**, 1984, pp.64-87.

However, the inter-war period with its economic and political instability was not ideally suited to central bank coordination, though the Bank of International Settlements was set up in Basel with this end in view. Apart from political differences, the monetary ambitions of the major countries rendered coordination difficult, if not impossible. Not only the traditional rivals, the Bank of France but also the Americans (including at one stage, the most pro-British of the American Federal Reserve Banks, the Federal Reserve Bank of New York) were suspicious of British designs. On French suspicions, see A.Boyle, **Montagu Norman**, London, 1967, pp.231-232. Moreau, the Governor of the Bank of France said Norman wanted to put "Europe under a veritable financial domination" by Britain. On American suspicions, see C.Parrini, **Heir to the Empire : The United States Economic Diplomacy**, Pittsburgh, 1963. Henry Clay, **Lord Norman**, London, 1957, p.265, quotes Benjamin Strong, Governor of the New York Federal Reserve Bank, echoing European complaints of Britain establishing a "dictatorship" over their central banks.

ambitions and suspicions that we have referred to in the above footnote, there were many reasons why conditions did not conduce to the creation or survival of a stable gold exchange standard based on the sterling. The models of instability that we have referred to earlier, pertained to a key currency country which had departed from disequilibrium. In the case of the sterling, we are talking about a currency whose key currency role depended on political agreements and when it was some way below the desired par. Britain's hope was that if a sufficient number of countries pegged to the sterling and held it in their reserves, this disequilibrium could soon be eliminated. But the sterling's premature return to gold only built price disequilibria into the system, especially for countries which did not possess a real freedom of exchange rate policy.[81]

Not only was Britain hoping to preside over an exchange standard of currencies that were linked to a floating sterling but also, she wished to do so at a time when her main instrument of attracting capital from abroad was in some disarray. As we have noted earlier, London's ability to attract funds now depended practically on America's decision to export them. The downward inflexibility of London interest rates that this implied rendered the system much more volatile than earlier. London needed to increase interest rates significantly to attract capital but even a small uncoordinated drop lead to large outflows.[82]

Part of the reason that this was so was the large sums of private short-term capital, the so-called "hot money' to which we have referred earlier. Private

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[81] See in this connection, Cairncross and Eichengreen, **Sterling in Decline**, 1983, p.48.

[82] Norman told the Macmillan Committee that if it had not been for the struggle of gold, that is to say (he clarified), the flow of gold from one place to another, "we would not have anything like the difficulties in maintaining the exchange that there have been." Qn.3491, **Proceedings**, 1931. Therefore, the sterling had constantly been "under the harrow" in regard to its international position (Qn.3319).

speculative capital flows rendered the gold exchange standard more unstable and meant that stop-go domestic policies in Britain to maintain external balance would get accentuated without resolving the underlying problems if British policies reflected or led to a climate of global monetary tightening.

Thirdly, models of the gold exchange standard usually assume that the system is built around one reserve currency. But the inter-war system depended in differing degrees both on the sterling and the dollar which were therefore, to an extent, competing reserve currencies. The dollar would have provided sterling holders an attractive asset into which they could move at the first signs of its weakening. The British fear of an American interest rate rise or of the cessation of American lending abroad arose partially for this reason.

Lastly, the distribution of sterling assets in the inter-war gold exchange standard provided one major reason for its instability. There were two large sterling holders in the system. The Empire was one. But Empire holdings were a stabilizing influence. On the other hand, the huge accumulation of sterling paper with the Bank of France was not only de-stabilizing but was also feared to be so by the Bank of England and the Treasury.[83]

The shortages of the primary reserve that Britain faced, the enfeeblement of her traditional instruments of correcting them, the difficulties in making the domestic adjustments needed to return to the gold standard, the obstacles to and the slow progress of international agreements or action on stabilization and, after the

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[83] On the distribution of key currency assets influencing the stability of the gold exchange standard, see P.B.Kenen, **Reserve Asset Preferences and the Stability of the Gold Exchange Standard,** Princeton, 1963. Also see PRO T160/430, F.12317/1, Leith-Ross to Waley, letter dated 30 May 1930 and undated, untitled note by Leith-Ross for Hopkins and the Chancellor in the same file which discusses the Bank of England's concerns in the matter and "Conversations with France on Financial Relations" in F.12317/1-3 which contains a record of talks between the British and French Treasuries mostly about French pressure on the Bank of England's gold reserves.

sterling's return to gold, its precarious stability, provide the background against which the many pieces of British monetary policy in India fall into place. Britain's ability to adjust Indian asset demands to suit her own liquidity position, which arose through her control over Indian monetary policy, formed an important part of her adjustment framework and partly explains why she never let go this control till the end of her rule over India.

I.6 GOLD FOR INDIA : CHANGING BRITISH PERCEPTIONS

As Britain moved towards encouraging the holding of sterling rather than gold in the reserves of the smaller central banks of Europe, she also moved away from an attitude of relative indifference to India's private reserve appetites. Before 1913, while British financial opinion had, with few exceptions, encouraged the investment of India's official reserves in sterling paper, there was not the same consensus with regard to India's private reserve demands. Bankers in London, fearing that the Bank of England's gold reserve was inadequate, tended to view with alarm the increase in India's private absorption of gold especially in the last five years before the war. The India Office did what it could to assuage these fears by selling rupees far in excess of treasury requirements and in excess of budget estimates.[84]

But in general, the attitude dominated that the Indian private sector was entitled to import what it wished, in return for its exports. The Treasury and the India Office largely desisted from active steps to curb Indian private demand for gold before 1914. Reducing the Indian gold demand was seen as a long-range problem best tackled through the development of banking institutions.

But during the First World War, Indian gold imports, both private and official, were

[84] **The Statist** dated 14 June 1913.

kept in check to enable Britain to finance her war imports from countries such as the USA which refused to export against sterling credits, to strengthen sterling in the exchange markets and support monetary expansion necessitated by the war.

Even after the war ended, the conditions created by the war, as we have seen, rendered gold more rather than less important to the global financial system. Attempts to shift the liquidity demands of the East away from gold towards silver continued. The switch became more problematic as silver prices rose and the rupee had to be revalued to avoid coining silver rupee tokens at a loss and the melting down of minted coins. As we shall examine in Chapter **III.1.A**, it was the fear of large monetary gold flows that primarily motivated the deflationary policy adopted in India in 1920.

While the India Office was concerned, in keeping with the pre-1913 practice, to prevent monetary gold flows, the Treasury showed itself interested also in the private, non-monetary demand for gold by India. It thought that if free gold movements to India were allowed at the same time as the rupee was stabilized at 2s gold (both measures had been proposed by a 1920 currency committee), India would attract much of the newly mined gold besides diverting American releases of the metal from Europe. In doing so, the Treasury felt, India would cause an increase in the value of gold in relation to that of commodities and delay the return of sterling to gold. The immediate reason for the fear of large gold movements to India was, of course, that the war controls had created a premium on the metal in India. The Treasury, as we see in Chapter **III.3**, allowed the controls to lapse only when it was certain that it would not increase gold absorption by the private sector in India. As far as one can ascertain, this was the first explicit peace-time attempt by London policy-makers to regulate the flow of non-monetary gold to India.

London's attitude to private gold imports by India became more remarkable in the

1920s. With delayed cost and price adjustments, Britain found that her traditional markets including those for textiles were increasingly being shut to her exports. India was one such market which by the mid-1920s was turning away from British sources of supply especially for cotton textiles and towards other sources including domestic ones. Accompanying this decline in the Indian demand for British exports was the perception of a substantial increase in India's private imports of gold.[85]

The interpretation was therefore advanced that Indian gold imports were a substitute for manufactured consumer imports, whose purchase the Indian householder deferred because of their high prices. High import prices and the cheapening of gold as sterling rose closer towards parity meant, according to this interpretation, that the Indian income-earner preferred to stock gold while waiting for the prices of his imports (which remained high because of delayed cost and price adjustments in Britain) to fall. This economic chain was offered as a thinly veiled argument for a revaluation of the rupee.[86] The argument is examined in closer detail in Chapters Four and Five but the point we should note here is that an Indian revaluation would pass on to India a part of the British burden of adjustment to the post-war price situation.[87] In the short run, a rupee revaluation would render British exports to India more competitive regardless of their sterling

[85] Indian cotton textile imports fell from Rs.1021 million in 1920/21 to about Rs.650 million in 1925/26. This was above pre-war values if not volumes. Net imports of gold coin and bullion were Rs.40 million in 1919/20, Rs.412 million in 1922/23, Rs.292 million in 1923/24, Rs.740 million in 1924/25 and Rs.349 million in 1925/26. There is a further steep fall in the next year. All figures from **Statistical Abstracts for British India**. Also see J.D.Tomlinson, "The Rupee/Pound Exchange in the 1920s", **IESHR**, Vol.15, No.2, 1978, p.133 and "The First World War and Cotton Piece Exports to India", **EHR**, Vol.32, No.4, 1979, pp.494-506.

[86] See Blackett's evidence to the Hilton-Young Commission in IOLR V/26/302/8, Qn.434.

[87] R.S.Sayers, "The Return to Gold" in S.S.Pollard ed., **Gold Standard**, 1969, p.92 and p.98 suggests that in the inter-war period, Britain could no longer, as she had been able to do before the war, spontaneously pass on the burden of her adjustment to other countries. However in the Indian case it would seem as if a part of the burden was transferred through the expedient of short-term policy.

prices. In due course Indian costs and prices would adjust to render the competitive advantage for Britain a one-off process. But, as while seeking to delay price adjustments in the Indian cotton textile industry to the revalued rupee by accepting a cut in the excise duty on Indian cotton manufactures in order to prevent an imminent fall in Indian textile wages, some British authorities expected that British adjustment to post-war costs and prices and to the sterling's resumption of the gold parity would not be long in coming.[88] In the meantime an Indian revaluation would reduce the burden of adjustment for an important segment of Britain's sick cotton textile industry. Further, if as a result, a reduction in India's private gold absorption could be managed, there would also have been some domestic expansionary influence in Britain.

Through the early and mid-1920s, one argument advanced to support a rupee revaluation was that of the need to check price increases in India. This conveyed in a short-hand form the problem posed by the composition of Indian imports diverging from what would have been ideal from the point of view of British finance. Apart from what has been stated in the previous paragraph, there are two further reasons why this point could be made.

Firstly, Indian price indices were formulated in a way that dis-proportionately reflected the prices of India's importables (i.e.,imports and import substitutes), especially of textiles. These price indices were unweighted averages though some system of weighting was achieved by the number of quotations taken for each commodity in the notional consumption basket. For example in Calcutta, cotton manufactures accounted for 7 out of 73 quotations, raw cotton and silk between them for five. Food accounted for 33 quotations of which cereals accounted for 8. Pulses accounted for 6 and sugar (an import during the 1920s) for 5. The

[88] B.Chatterji, "The Abolition of Cotton Excise, 1925 : A Study in Imperial Priorities", **IESHR**, Vol.17, No.4, 1980, p.376.

implication was that the average Bengali spent some 16% of his disposable income on clothing and 45% on food (of which 15% was spent on imported sugar). He spent only fractionally more on cereals than he did on cotton manufactures and more on the latter than he did on pulses.

The Bombay index tells a similar story. Cotton manufactures accounted for 7 out of 42 quotations, other textiles 2 and raw cotton 3. So the - no doubt vain - citizens of the Bombay Presidency spent about 30% of their income on clothing; as in Calcutta, only slightly less was spent on cotton manufactures than on cereals.[89]

The second reason why we may suggest that inflation was merely a convenient explanation for accomplishing a revaluation in India relates to the discriminating use of the exchange rate instrument. In 1920 when the rupee was revalued to 2s. gold and again towards the mid-1920s when the rupee was pushed in the course of floating beyond 16d., the reason advanced was the need to mitigate inflation in India. As we point out in Chapter Three, in 1920 Britain was running higher rates of inflation than India and the USA and she was urging the latter to inflate further so that the extent of British deflation might be reduced. Therefore faith in the use of the exchange rate instrument to check Indian price increases seems at one time to have been so great as to render it usable when the rest of the world was inflating or was expected to inflate. However when prices collapsed in the depression, even after it was recognized that Indian prices had fallen by much more

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[89] Price index composition from IOLR L/F/5/100, Financial Department Statistics, pp.188-190. The above does not tell us how many quotations covered imported manufactures and how many covered indigenous manufactures. This distinction is not necessary since one would expect the two prices to move together. Clearly the assumptions on which these indices were based were quite different from India Office assumptions on the pattern of consumer expenditure in India that were expressed at other times. In 1933, the India Office thought only about 10% of the average farmer's income could be spared for purchases of manufactures including farm implements. See IOLR L/F/6/1201, F.1291, Kisch's remarks to the League of Nations, Monetary and Economic Conference : Preparatory Commission of Experts, II Section, Provisional Minute, III Meeting, Geneva, 10 January 1933.

than British or world prices, the use of the exchange rate to stabilize domestic prices in India was rejected on the ground that it would leave relative costs and prices (once the necessary adjustments took place) unchanged, and until then, Bombay manufacturers would make windfall profits.[90] Therefore one reason advanced for rejecting a devaluation of the rupee as prices collapsed in the depression derived from the so-called neutral money argument.

But even this argument was not consistently held. One of the justifications advanced for the adoption of the 18d. rupee in 1926 was that, that rate had prevailed for two busy seasons during which time Indian prices had adjusted to the rate.[91] By 1931 when Indian prices had fallen far more than world prices the argument was no longer the lack of adjustment between Indian prices and world prices and the need to accomplish the adjustment through an exchange rate change. But the argument was that a devaluation of the rupee would increase the rupee cost of servicing India's sterling debts. But in terms of the neutral money argument, as the rupee fell, prices etc. would have adjusted to leave the real value of transfers unchanged. Similarly, government revenues would have adjusted to leave the size of revenue transfers in relation to total revenues intact. The resource transfer problem like the advantage to the Bombay mill-owner would have been an one-off problem.[92]

Therefore the India Office and the Government of India both advanced two contradictory arguments to resist a rupee devaluation in the depression, simultaneously. One argument rested on the neutrality of money assumption and the

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[90] IOLR L/F/6/1183, F.6444, "The Effect on the Indian Economy and Credit of a Collapse of the Rupee Exchange", memorandum by Kisch dated 18 September 1931.

[91] Report of the Hilton-Young Commission, para.176.

[92] See for example IOLR L/F/5/189, "The Exchange Question", note by Kisch dated 24 November 1930.

other repudiated it.

The discretionary use of the exchange rate as a policy instrument thus would have reinforced deflationary pressures on the Indian economy during the inter-war period. The inflation argument gave the working out of these pressures a gloss of virtue. In the context of liquidity needs at the centre, Indian deflation was necessary at this time to forestall her demand for primary liquidity and if possible, to replenish it through making her dishoard gold. The view of the India Office in relation to Indian gold exports in the depression that they merely represented exports of gold that arrived in India in the 1920s implies that London no longer felt obliged to meet India's non-monetary gold demand in the inter-war period any more than she was inclined to meet her monetary gold demand.[93]

I.7 WHITEHALL AND INDIAN MONETARY POLICY

Faced with the possibility that India might set up a limitless demand for the world's gold, control over Indian monetary policy and institutions was crucial to the British interest. It has been argued that the only British motive for seeking the final say over Indian monetary policy was the need to secure the orderly servicing of Indian debt and other obligations.[94] That Britain's experience with countries on the periphery in regard to debt servicing in the depression was rather more successful than that of the Americans is well known. Many more American borrowers defaulted than British and none of the British colonies or dominions defaulted. Argentina, the only Latin American country not to default, was strongly tied to

[93] See for example IOLR L/F/6/1180, F.6060, newspaper cutting dated 26 January 1932 reporting a speech by the Viceroy.

In the 19th century too, Britain sought to regulate gold movements to India in order to strengthen the gold standard and the position of the sterling. See Asiya Siddiqui, "Money and Prices in the Earlier Stages of the Empire : India and Britain, 1760-1840", **IESHR**, Vol.18, Nos.3&4, 1981, pp.231-62.

[94] Tomlinson, **Political Economy**, 1979, pp.126-127.

London though that did not prevent British officials from urging her to default on her debts to the USA![95]

But debt servicing as the sole British interest in preventing a movement towards monetary autonomy in India does not convince. Though as early as the late 19th century some Indian politicians had begun speaking of a drain of Indian wealth to Britain, debts were not a contentious issue before 1913. Even after the war, controversies about India's sterling debt related only to the fact that a large proportion of Indian official debt was being contracted in London rather than in India, the dominant opinion among the Indians being that overseas borrowing was necessary to develop the infrastructure in India. There was some criticism of the government's stores purchase policies but very little of its borrowing policies. Complaints of India's debt burden and the deflationary costs of servicing them were really a product of the depression.

But even in the 1920s, the India Office and London financial interests (including, to a certain extent, the Bank of England) were loathe to hand over control of Indian monetary policy to the Indian government or an Indian central bank. The Bank of England and some senior Treasury officials saw the advantages of an orderly

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95 De Cecco, "International Debt", **BNDLQR**, 1985, p.63, and Diaz Alejandro, "Latin America in the 1930s", in R.Thorp ed. **Latin America in the 1930s : The Role of the Periphery in the World Crisis**, London, 1984, p.27. Also see A.O'Connell, "Argentina into the Depression : Problems of an Open Economy", p.208 in the same volume.

M.de P.Abreu compares Brazil and Argentina in the depression, especially the relation of the two countries to their creditors and the space each of them secured for carrying out independent domestic stabilization policies. Over 1932-37, Brazil piled up commercial and financial arrears with the USA because of foreign exchange shortages while her servicing of sterling debts accounted for 20% of the import bill. Because of the importance of her market for Argentinean meat (and the clout of the local cattle interests) Britain got favoured treatment in Argentina without which her adverse balance would have worsened. Had Argentina been less pliable and as independent as Brazil, she could have grown faster in the depression. American strategic leniency enabled Brazil to grow. British "orthodoxy" curbed Argentinean growth. See M de P.Abreu, "Argentina and Brazil during the 1930s : The Impact of British and American International Economic Policies", in R.Thorp ed., **Latin America**, 1984, pp.144-162.

transfer of power to Indian monetary institutions, but in a manner that preserved London's effective control over the broad formulation of monetary policy in India.[96]

There are two cases from the 1920s which throw light on the lukewarm India Office and London attitude to monetary devolution in India. The first arises in the context of the conflict between Delhi and Whitehall regarding the procedure for the sale of sterling and is discussed in some detail in Chapter **IV.3**. The second example, which is discussed briefly below, relates to discussions about the establishment of a Reserve Bank in India in the late 1920s. This incident also highlights certain London interests beyond those normally associated with the India Office.

Though outside its original brief, the Hilton-Young Commission recommended the establishment of an Indian central bank, the Reserve Bank of India(RBI). From the very beginning, the India Office was not enthusiastic about this proposal. However they focused attention on the practical problems of working the bank were it to be independent of the government. The India Office witness conceded to the commission that the RBI would de-politicize monetary policy in India but also insisted that a representative of the Secretary of State should be a member of its board in London because of his interest in gold flows to India and the need for exchange market intervention to accelerate or impede the flow. He could also keep

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[96] In any case, monetary autonomy - the power to formulate financial policy without reference to Whitehall - was not synonymous with policy autonomy. A small open economy is vulnerable to instability and exogenous shocks, but also it becomes a part of a larger power system at the global level. For this reason, the depression (which to some extent caused a break-down of this power system) forced many countries to adopt inward looking economic policies. See A.O'Connell, "Argentina" in R.Thorp ed. **Latin America**, 1984, p.189. Monetary autonomy in India within an open economy would have meant merely greater sensitivity of the policy-makers towards the expansionary urges of domestic opinion, though the tension that would have arisen between expansionary policy and the constraints of an open economy might in the end have become sufficiently irreconcilable to require the cessation of one or the other. In contrast, the conflicts in regard to fiscal autonomy were more straight-forward and predictable.

Delhi in touch with the state of Indian government investments in London.[97]

Strangely, speaking for an establishment which at a later date was to set so much store by the "independence" of the RBI, Kisch initially ruled out the British model of an independent central bank and recommended instead the French model in which the Bank of France worked in close coordination with the government. He wanted the management of the Bank to be appointed by the government and said in the beginning at least, it would be better to increase government control than to reduce it.[98] He explicitly rejected the Genoa and Brussels resolutions on the independence of central banks as unsuitable for India and argued that a close association between the Bank and the government was necessary to strengthen the former's independence with respect to "outside parties".[99] He even recommended close links between the legislature and the future central bank since the Government of India was responsible to the former for exchange policy![100]

The earliest reference to a "non-political", "independent" central bank for India comes from Henry Strakosch - a member of the commission who had also helped formulate the Genoa resolutions. His reasons for suggesting an independent central bank are interesting. Anticipating a concern that was to come to the fore in later years as open control of monetary policy from London was seen to become increasingly indefensible, Strakosch told Blackett that an independent central bank was necessary as India was moving towards greater popular representation.[101]

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97 IOLR V/26/302/8, Qns. 11179, 11181-83, 11627, 11439-449.

98 IOLR V/26/302/8, Qns. 11141-11147.

99 IOLR V/26/302/8, Qns.11623, 11625.

100 IOLR V/26/302/8, Qn.11140.

101 CCA Htry 1/3/2, Strakosch to Blackett, letter dated 17 October 1925; also see PRO T176/25B, Strakosch's note "Imperial Bank of India", dated 28 February 1926.

Despite the commission's support for an independent central bank, the attitude of the India Office to the question was widely expected to be obstructive rather than helpful. Soon after he gave his report, Hilton-Young wrote to Niemeyer to complain about the "obstructive" attitude of the India Office, adopted "in the hope that something may turn up to scotch the idea of a Bank of Issue and so preserve the influence of the Secretary of State ...." Niemeyer agreed that the central bank proposal would "stick in the gullet of the India Office" and agreed to have some pressure put on the India Office from the Chancellor.[102] In the event the RBI legislation turned out rather well for the India Office. Its rigidity on the principle of dissociating the legislature and the government from the management of the RBI, which was in such contrast to its earlier arguments before the commission, ensured that the 1927 RBI Bill would not become an Act.

The opportunity to postpone the RBI legislation arose as a result of a stalemate that had arisen in talks between the Indian government (constrained by an inflexible India Office) and Indian politicians on the bill. The latter sought a greater say for legislators in the elections to the management boards of the RBI. The India Office wanted any such proposal ruled out explicitly and held that if the exclusion of legislators was not practicable, the bill should be withdrawn.[103]

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[102] PRO T176/25B, Hilton-Young to Niemeyer, letter dated 19 October 1926; Niemeyer to Hilton-Young, letter dated 20 October 1926; IOLR L/PO/2/3(i), Chancellor to Secretary of State, letter dated 21 October 1926. Niemeyer in his letter to Hilton-Young promised to "stir up other gadflies as well". When Kisch saw the Chancellor's letter, he suspected that London opinion was being mobilized against the India Office. He observed a "curious simultaneity" in the reminders of Hilton-Young, the Chancellor of the Exchequer and the Indian Government; see his note dated 22 October 1926 and Secretary of State to the Chancellor, letter dated 22 October 1926.

[103] IOLR L/F/7/2292, Colln.375, File 19, part 3 Secretary of State to Viceroy, telegram dated 7 September 1927 and Viceroy, to Secretary of State, telegram dated 10 September 1927. Earlier the India Office asked the Government of India to seize the chance provided by a Moslem demand for communal representation as a strong tactical basis of withdrawing the RBI bill. The onus of failure, the India Office said, could then be laid at the door of the Indian politicians. See IOLR

An understanding of what London financial interests sought to preserve, after the transfer of power over monetary policy to a nominally Indian body in 1927, is to be obtained from communications between London and New Delhi over the RBI bill. The India Office not only did not share Delhi's confidence that essential London interests would be secured irrespective of the composition of the RBI board, but also, it used Blackett's proposals to undermine his position in the eyes of the City and seek Bank of England support to derail the RBI legislation.

In the course of one of his informal talks with Indian politicians, Blackett departed from his narrow brief and conveyed hints that he might support a modified version of a non-shareholders bank with some role for legislators. The India Office was outraged. Apart from criticising Blackett to the Viceroy and asking him to restrain his subordinate, it saw the chance to end the RBI charade at least for the time being and began to mobilize support for its view that the establishment of an Indian central bank should be postponed indefinitely. The Bank of England was appraised of the latest ideas from Delhi and, according to an India Office note, the Governor expressed "consternation" that a Bank "which must of necessity have an almost predominant position in the London Money Market (besides holding the assets of the Government of India and the Indian banks) should be in the hands of a directorate so constituted."[104]

Mss.Eur.D/703/27, Secretary of State to Viceroy, Private & Personal, telegram dated 3 September 1927. Ironically, in the early years of the RBI, the Government of India would choose a Deputy Governor of the Bank on a communal basis! A revised bill was finally withdrawn and the chapter closed in February 1928. As Kisch pointed out to Kershaw, Blackett's wish of a "Bank Bill in my time" had gone too far and it was necessary to withdraw the bill and wait for a new finance member. IOLR L/PO/2/3(i) Kisch to Kershaw, letter dated 2 February 1928. When the RBI was finally set up in 1935, it had no power over exchange rate policy and was committed to defending the 18d. rate.

104 IOLR Mss.Eur.D703/27 Viceroy to Secretary of State telegram dated 9 September 1927 and 14 September 1927 and IOLR L/PO/2/7(ii), note by A.Hirtzel dated 16/9/27. Hirtzel referred to the Bank as not being solely an Indian domestic concern. A telegram from London said "... the idea of entrusting assets of the

It is clear from the Governor's reaction that he was apprehensive, not about the RBI's commitment to specific exchange rates nor its willingness to discharge sterling liabilities, but that his anxiety related more fundamentally to the RBI's position as holders of sterling assets. Against the background of the debate about a gold standard for India, the movement of the dominions away from sterling in the mid-1920s and the growth of short-term sterling liabilities especially to the Bank of France, the last thing the Bank of England would have wished was uncertainty regarding the investment of Indian reserves in sterling paper and its effect on other sterling holders. Were the uncertainty to arise, Indian sterling holdings, rather than being a source of stability for the sterling, would have become a source of extreme instability.

The Bank of England's interest in the future RBI's investment policies is clear from a letter to Blackett written by his friend Harry Siepman who was a senior employee in the Bank and a close associate of Norman. The letter which was written under the assumption that an Indian Reserve Bank would soon come into existence said that the Bank of England had come to the conclusion that it would arrive at an "understanding" with the future Governor of the RBI, involving "no agreement, no document, nothing that could be quoted or enquired into but complete freedom in form ... (for the Governor) to do as he likes with his money and simply a voluntary arrangement by which he tells us of his actions and intentions and we tell him

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Government of India and Indian Banks..." to such a directorate was received in the City with "mingled consternation and ridicule." Telegram dated 14 September 1927. Another communication said the City had begun to question Blackett's judgement. See Birkenhead to Irwin, letter dated 22 September 1927 which said "...I am afraid that he (Blackett) has smirched his financial reputation very badly." The latter may have been in the nature of a threat to Blackett about his future career in the City and a hint that his "future depended on his being amenable ...." P.J.Grigg, who was the Finance Member of the Government of India in the 1930s and to whom the above quote owes, thought such methods were used by London to keep Indian civilians in line. See CCA Grigg Papers, 2/22, Grigg to H.J.(Rowlands), letter of no date but written in September 1938.

whether or not they would suit our book."[105]

Therefore it is hard to find support, at least from the 1920s, for the view that the British government refused to "compromise" over Indian monetary policy because "the Treasury was convinced that the British tax-payer would be left to foot the bill should the Government of India ever default on its sterling debt."[106] In the 1920s debt defaults were never a major issue. They became issues only in the depression as primary prices collapsed to increase the real burden of debt and defaults by poorer countries became almost respectable.

The reluctance to grant India "monetary autonomy" then requires explanation especially when one contrasts this with the relative ease with which formal fiscal autonomy was granted to India immediately after the First World War.[107]

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105 IOLR Mss.Eur.E397/31, Siepman to Blackett, letter dated 4 February 1928. Siepman was closely involved with European stabilization as an employee of the Bank of England. The first Governor of the RBI was a close friend of Norman's and his name had been in the reckoning in the 1927 discussions as well.

106 Tomlinson, **Political Economy**, 1979, p.105.

107 Tomlinson, **Political Economy**, 1979, p.121 argues that India enjoyed a degree of monetary autonomy in the 1920s which was eroded in the depression. The temptation to perceive a movement in monetary management parallel to tariff autonomy is great but the evidence seems weak. In attempting to prove his claim, Tomlinson has had to stretch the evidence and base his case on a misreading of the sources. For example, he cites the Babbington-Smith Committee's decision in 1920 to peg the rupee directly to gold and propose a fall-back gold standard as proof that London was willing to let India go its own way on monetary matters. But as we examine in Chapter **III.1**, the committee agreed to peg the rupee to gold only after it was convinced that Indian trade would continue to be settled in sterling. The gold standard was proposed for the eventuality in which it became impossible to buy silver. He also quotes the change in sterling purchase procedure in the 1920s and the Hilton-Young Commission's gold bullion standard proposal to support his view. The new exchange operations are discussed in Chapter **IV.3**. The fiction of the gold bullion standard is discussed in some detail in Chapter **V.2**.

Tomlinson perceives a certain "liberalism" in India Office and Government of India attitudes towards monetary devolution in India in the 1920s and a hardening of attitudes in the 1930s. There is no evidence of Whitehall "liberalism" in the records and such liberalism as existed did nothing to shift the fulcrum of financial policy- making away from London. If one wishes to seek a "liberal" phase, one should perhaps go back to the decade before 1913. The pioneers of the Indian currency system, especially Lionel Abrahams had a sense of vision which the post-war generation of India Office Finance Department officials lacked. Abrahams, There exist broadly speaking two views on the Indian fiscal autonomy convention. Clive Dewey argues that it represented a victory for the government in New Delhi defending specific Indian interests, over Whitehall. The other view is that of B.Chatterji who sees the convention and its practical working as a response to political pressures on the periphery including the threatened growth of political extremism and who sees the convention as merely refining the exercise of Whitehall control in a vital area rather than eliminating it.[108]

The sterling debt explanation for denying India monetary autonomy is clearly unsatisfactory. In our view, there were several proximate reasons for the denial of monetary autonomy to India in the inter-war period though the underlying objective was always the same. In the 1920s the reasons related directly to the need to mitigate the stress of the domestic adjustment that Britain needed to make to return to the gold standard at the pre-war parity and safeguard its key-currency role and the position of London as a financial centre. In the depression years the question of sterling obligations played a role not so much because of any potential burden to the British tax-payer but because of the effect an Indian default (or checks on short-term capital outflows) would have had on the sterling and London's liquidity position within the global financial system. Secondly, control over Indian

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Holderness and other officials of the pre-war period were often racked by doubts about the course they had chosen. See for example the correspondence between Keynes and the India Office officials in **JMK**, Vol.15. However the eclipse of Lionel Abrahams in 1919 and the rejection of his more cautious approach towards post-war stabilization in India brought to the fore a less idealistic, if not more cynical, group of officials who controlled Indian financial policy till the 1940s. Contrast for example Abrahams' self-doubting note to Keynes (**JMK**, Vol.15, pp.38-39) which expresses the former's doubts about a system which was on the whole working well and the comments of Kisch and Howard justifying the stabilization attempt of 1920 despite its visibly disastrous effects on Indian trade and incomes (**III.3**).

108 Clive Dewey, "The End of the Imperialism of Free Trade : The Eclipse of the Lancashire Lobby and the Concession of Fiscal Autonomy to India" in C.J.Dewey and A.G.Hopkins, eds., **The Imperial Impact : Studies in the Economic History of Africa and India**, London, 1978, pp.35-67. B.Chatterji, **Lancashire Cotton Trade**, 1978 and "Business and Politics in the 1930s", **MAS**, 1981, p.573.

monetary policy was essential also to ensure that India's role in releasing gold to ease the recovery of a liquidity-starved centre would not be affected. The need to harmonize parities in the sterling area and create a zone of exchange rate stability may also have mattered.

London's ability to deny India any significant measure of monetary autonomy is also a testimony to the strength of the London financial interest and the ability of the India Office to draw its considerable political and moral support. Compared to the City, Lancashire had little clout. That even a Treasury official of Blackett's standing could in the end be defeated by India Office inflexibility on the Reserve Bank points to the resources the India Office could deploy when its positions were in accord with the interests of the City. For most of this period, the interests of the City and the country were seen to be synonymous.[109]

ORGANIZATION OF THE THESIS

The chapter is organized as follows. The next chapter, i.e., Chapter Two examines Britain's liquidity crisis arising from the First World War and her efforts (jointly with the USA) to switch India's liquidity demands away from gold towards silver. Chapter Three discusses the efforts to prevent a deferred Indian demand for first class liquidity and to give the above shift a more permanent character. The Babbington-Smith Committee recommended a deflationary stabilization package for India and the motivation underlying it is studied in this chapter. Chapter Four discusses the regime of managed float for the rupee in the background of the sterling's return to the gold standard at the pre-war parity. Chapter Five discusses motivations behind the stabilization package and currency reforms proposed by the

[109] S.S.Pollard, "Introduction", in S.S.Pollard, ed., **The Gold Standard**, 1969, pp.24-26.

Hilton-Young Commission. The period covered by Chapters Four and Five (i.e. 1921-1927) represented a working out of a policy similar to that which failed in 1920. The accent in the latter period was on a more gradual move towards the same objectives that governed early post-war stabilization. The period and the policy culminates in the depression of the 1930s which among other things resulted in large gold exports by India. The significance of these exports and the policies that led to them are discussed in Chapter Six. Chapter Seven is in the nature of a conclusion.

CHAPTER 2

The Liquidity Problem in World War I

II.1 British Finance in the War
II.2 Indian Trade in the War
II.3 The Pitman Silver Agreement
II.4 Conclusion

In many ways, the First World War was a water-shed for the history of the international monetary system during the twentieth century as also for Britain's position within it. The large increase in imports and the disruption of her exports increased the imbalance of Britain's trade account. The decline in her receipts on the invisible account together with lower overseas income - as her dollar securities were liquidated in the war - meant that in the end, Britain's gold reserves themselves would come under threat and jeopardize the survival of the sterling on the gold standard. Making matters worse was the fact that Britain emerged from the war heavily in debt to the United States. The war also resulted in large movements of gold across the Atlantic to the United States and heralded the distribution of world monetary gold in favour of the latter - a development which began to appear to Britain as a gold shortage.[1] These factors resulted in the erosion of Britain's leadership role in the global financial system and in the growth of American financial strength. In the end, Britain never really recovered her financial standing from the shocks it received in the war. As such, the history of the inter-war financial system is in many respects the history of British efforts to mobilize all her diplomatic, financial and economic resources to stave off the American challenge. Where that proved impossible, it chronicles British attempts to co-opt American power and influence to its own ends and the ambiguous response of the latter to these efforts. Our story therefore begins with the war.

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[1] See **Report** of the Macmillan Committee, 1931, paras 140-143.

This chapter is organized as follows. The first section briefly examines Britain's financial position in the war particularly in relation to her war imports from the United States. The second section discusses the effects of the war on Indian trade and the problems that faced the Indian financial system as a result of the non-availability of the traditional means of financing her trade. The section that follows discusses the main attempt to switch Indian asset demands during the war through the Pitman silver deal with the USA. The last section summarizes the argument.

II.1 BRITISH FINANCE IN THE WAR

The first question of fundamental financial importance facing Britain in the war was that of preserving the convertibility of sterling into gold. Even before the war, a number of British joint-stock bankers felt that the Bank of England's gold reserves were inadequate in relation to her domestic and external liquid liabilities. Typically too, much of this clamour emanated in relation to the demand for gold from India.[2] With the threat of hostilities in Europe, these bankers began to fear a run on their own gold reserves and tried to contrive a suspension of sterling convertibility.[3]

At this time, the views of the bankers did not find universal support. Only some months previously in May 1914, Basil Blackett, who was at this time a Treasury official, had rejected them and argued that in a general European war, British gold

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[2] See for example the speech by E.H.Holden, Chairman of the London City and Midland Bank, at the Annual General Meeting of the Bank on 24 January 1913. Pointing out that the problem of inadequate gold reserves was not only a British problem but a general European one, he attributed it to India's gold absorption which he estimated at 30% of annual gold output. Gold flowed to India easily enough, but "... we have the more difficult problem of how the gold is to be made to flow out of India".

[3] For details of these developments, see Marcello De Cecco, **Money and Empire**, 1974, pp.144-170.

losses would be prevented by a high domestic discount rate and increased insurance premia on gold shipments.[4] Blackett was in effect emphasizing that the gold points would widen in the event of war and monetary gold losses would be insignificant unless Britain faced physical invasion. However he, like others at the time, under-estimated the difficulties of financing the war. The worst scenario that he could conceive was one in which monetary stringency was tackled through an "extension of the fiduciary issue of notes ... sufficient to meet our needs."[5]

Keynes was also inclined to dismiss the difficulties of financing the war and the dangers to convertibility. In any case, he seems to have believed that suspending convertibility when there was no real threat to it would severely undermine London's role at the centre of the international financial system. In order to preserve the latter, he preferred suspending domestic convertibility.[6] Keynes' view prevailed in the end and Britain decided to preserve the **de jure** convertibility of the sterling.[7]

In practice however, gold exports were discouraged and by June 1916 all private exports of gold from Britain had ceased.[8] With the anticipated widening of the gold points, the pound was allowed to stabilize at $4.765 which was below the gold standard parity of $4.86.

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[4] PRO T170/14, "Gold Reserves", memorandum by B.Blackett dated 22 May 1914, para 48. Also reproduced in De Cecco, **Money and Empire**, 1974, p.191

[5] PRO T170/14, Blackett's memorandum dated 22 May 1914, paras 48-49.

[6] **JMK**, Vol.XVI, p.45.

[7] Once the danger of a run on their reserves diminished, the bankers also fell in line with this view. Holden expressed a widely-held opinion when he told his shareholders in January 1916 that if London was still a "free market for gold" at the end of the war, Britain will have "scored a financial triumph as important ... as a great victory in arms".

[8] PRO T172/643, memorandum by Keynes dated 17 January 1917, "The Probable Consequences of Abandoning the Gold Standard".

Britain's main external economic problem in the war arose because of her widening trade deficit which increased from 134 million pounds in 1913 to 784 million pounds in 1918. The annual average British deficit in these years was about 419 million pounds. Only a small part of this increase was contributed by the exceptional Indian trade surpluses with Britain during the war. With increasing demands for Indian raw-materials and the dislocation of her imports of manufactures, a trade deficit with Britain of 17 million pounds in 1915 became a surplus of 20 million in 1916, 39 million in 1917 and 40 million in 1918. This was not in itself a major problem as Britain could and did settle these deficits largely in sterling paper. However, problems peculiar to the Indian currency system, which are examined later in this chapter, also meant that a part of Britain's dollar reserves had to be spent to import silver into India from the USA. But more importantly, the British trade deficit with the USA grew enormously in the First World War, from 112 million pounds in 1913 to 507 million pounds at its peak in 1918, and averaged about 385 million pounds between 1914 and 1919. Indian surpluses with the USA, which Britain had used to an extent to offset her own deficit remained almost unchanged at about 12 million pounds between 1913 and 1919. With the disruption of world trade, Britain's receipts from services remained steady or fell, while her earnings from overseas investments which were stagnant between 1910 and 1913 would have fallen as she liquidated her long-term foreign investments to finance her imports in the war.[9]

The chief handicap that Britain faced in relation to trade with the USA was the latter's reluctance to export against credit, i.e. against sterling paper. The American refusal to accept key-currency assets when the key-currency country was

[9] Indian trade figures from **Statistical Abstracts for British India**, various years; British trade figures from B.R.Mitchell, **Abstract of British Historical Statistics**, Cambridge, 1962, p.284, pp.320-21.

itself facing a payments constraint generated a liquidity crisis for Britain which took the form of a dollar shortage or a shortage of the primary reserve, namely gold. The problem of a dollar-shortage has been commonly regarded as a major post-World War II financial problem for Europe.[10] But in some degree, its earliest manifestations were during the First World War and in its aftermath and the story of war financing for Britain was to a large extent the story of how it tried to tackle this particular problem. Britain's ability to draw freely on the resources of the empire helped her confront the liquidity shortage more than it has been hitherto realized.

Soon after the war started, Britain's traditional instruments of external financing were in disarray. The fluctuation of the sterling in relation to the dollar was unpredictable enough, as early as August 1915, to render the bank rate as a "method of attracting funds" from the USA "nearly useless".[11] By the middle of the same year, Britain's deficit with the United States (which was still quite small in relation to the levels it was to reach later) was threatening to lead to a collapse of the sterling. No more sterling sales were possible without a break in that currency, the Treasury's financial agents in New York warned.[12] The Bank of England borrowed from J.P.Morgan & Co. to steady the sterling. The "reported quarrels of Ministers, Newspapers, and English Generals ... " had made Americans in general doubtful about the success of the Allies and in contrast to the situation in

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[10] There is an enormous literature on the dollar shortage of the 1940s and the 1950s, though the shortage itself was soon remedied. See Thomas Balogh, **The Dollar Crisis, Causes and Cure**, Oxford, 1950 and D.H.Robertson, **Britain in the World Economy**, London, 1954. For a theoretical view that applied as much to the inter-war period as it did to the post-war one, see Hicks' famous "The Long-Run Dollar Problem", **OEP**, Vol.5, No.2, June 1953, pp.117-135. For a look at Britain's dollar-shortage problem in relation to India in the post-second war period, see B.R.Tomlinson, "The Sterling Balances Negotiations, 1947-1949" in A.N.Porter and R.F.Holland eds., **Money, Finance and Empire, 1790-1960**, London, 1985, pp.142-162.

[11] PRO T170/62, "The American Exchange and the Bank of England Discount Rate", memorandum by Keynes dated 13 August 1915.

[12] PRO T170/62, "Exchange", memorandum by E.C.Grenfell dated 20 July 1915.

February, "banks no longer consider(ed) a British Loan attractive". Urging drastic action to reduce the deficit and shore up the sterling, the memorandum warned British authorities that in the absence of such action, imports would become impossible and Britain would lose the war because of the collapse of her credit rather than any failure on the battle-field.

Coming to terms with the inevitable, Britain was forced, till the USA entered the war in September 1917, to discharge the bulk of her dollar liabilities even while preserving **de jure** convertibility and a dollar parity of $4.765. The financing was achieved through the conscription and sale (or their use as collateral) of dollar securities in the possession of British nationals, raising loans in New York and the export of gold to the United States.[13] Once the latter country entered the war, inter-government loans helped finance some of the British imports.

In their retrospective accounts of India's financial situation in the war, India Office and Government of India officials explained that restrictions imposed by "belligerent countries" prevented India from getting gold in liquidation of her trade surplus. Some later historians have echoed these explanations uncritically. But Britain herself had no formal controls on gold till March 1919 while American controls on gold outflows were not imposed till September 1917. The question we have to examine therefore is really, what accounted for this informal check on gold flows to India. The question is valid not only for its own sake but also to gain an essential insight into India's financial problems in the war, post-war stabilization policy in India and the motivations underlying them.

As we know already, the informal ban on private gold exports made the sterling inconvertible for all practical purposes. Apart from its use in payment for imports

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[13] R.S.Sayers, **The Bank of England, 1891-1944**, Cambridge, 1976, Vol.1, pp.90-91.

from the USA, gold was crucial to British war financing to underpin the enormous credit structure that the war had given rise to, and mitigate its effects on the sterling. As Hawtrey, the Treasury economist, put it, "the inflationary impact of excessive new borrowings was threatening to drive gold abroad ... (or) to depreciate the pound sterling. The greater the supply of gold, the greater the amount of credit money we can create without losing all our gold".[14]

Further, Britain needed gold more directly to shore up the sterling at her new parity, this being crucial to enable Britain to raise resources in New York. For the same reason the Bank of England and the British Treasury were keen to see that New York did not lose gold sufficiently to make loan issues there either impossible or expensive. They poured what gold they could into New York, actively intervened to prevent gold exports from the USA to the Axis powers and persuaded insurers to make gold exports to even the neutral countries difficult.[15] So great indeed was the competitive scramble for gold that there was at least one major quarrel on record between the Bank of England and the Treasury on the question. The former resented its gold holdings being used by the Treasury to raise loans in the United States on its own account to finance the war. So the Bank ordered its agents not to support the sterling in New York and to use part of its gold in Ottawa to discharge its obligations in New York. Serious recriminations broke out at once between the Treasury and the Bank. After protracted negotiations, the matter was settled and faces saved, resignations and damaging scandals averted when Governor Cunliffe apologised to Chancellor Bonar Law and promised to subordinate the Bank's gold policy during the war to that of the Treasury.[16]

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[14] PRO T170/100, Hawtrey's note dated 6 May 1916.

[15] Henry Clay, **Lord Norman,** 1957, pp.94-96.

[16] R.S.Sayers, **The Bank,** Vol.1, 1976, pp.84-94 and pp.99-107; see also H.Clay, **Lord Norman,** 1957, pp.94-96.

Compared to the gold liabilities piling up for Britain during the war, the Bank of England's gold reserves of about 35 million pounds at the outset of the war was tiny indeed. Therefore, joint-stock banks were asked to place their gold reserves at the disposal of the Treasury so that "the necessary gold exports to America may be made without unduly depressing the Bank of England Reserve".[17] By October 1916 the unexpected length of the war and the unforeseen difficulties of financing it only made the problem worse. Therefore, an inter-departmental committee was set up to consider the extent of dependence of the British Empire "commercially and financially on the United States" and the consequences of any reprisals adopted by the latter against Britain.[18]

The committee's report makes revealing reading. It said that a detailed examination of the financial position and prospects of the Allied powers and the United Kingdom in the USA revealed a "serious" situation. Of the $1038 million spent on the Treasury account in the USA, some 60% (or $618 million) had been met by the sale of gold ($316.68 million) and US securities ($301.89 million). The remaining amount was raised through loans ($400 million) and the depletion of Treasury balances ($19.43 million).[19] But the expenditure expected to be incurred over the next half-year was conservatively of the order of $1500 million. Recognizing a factor that was not theorized till some four decades later that the exchange rate is affected not only by the trade deficit but both directly and indirectly by the level of activity in the economy, the committee said all government expenditure including sterling expenditure would weaken the sterling and besides, the $1500 million estimate did not include the dollar costs of keeping the sterling at its war parity.

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[17] PRO T170/62, Bradbury to Governor of the Bank of England letter dated 24 August 1915.

[18] PRO T170/95, **Final Draft Report of the Inter-Departmental Committee to Consider Dependence of the British Empire on the United States**, October 1916.

[19] PRO T170/95, Para. 5 of the Report. The detailed figures are in PRO T170/92, unsigned, undated note, p.9.

Financing the expenditure posed a serious problem. US securities available for sale were now negligible and were best used as collateral for loans. As for gold, the Treasury had a reserve of nearly 100 million pounds which it would be "imprudent" to exhaust though it would in practice be impossible not to discharge at least half of it to the United States in this period. The $1250 million that was left to be borrowed represented 80% of all expenditure in the USA as against a loan financed component of 40% in the previous half-year. This amounted to loans being raised at the rate of $200 million a month whereas in the earlier period the New York market found the British monthly demand of $80 million difficult to meet. The Morgans thought this was a "staggering sum" and were "dismayed" by it.

In addition, there were demands to be met after March 1917. The Treasury's financial agents in New York hoped that Britain could be solvent after March 1917 by "postponing payments by bank over-drafts" till the USA was more able to digest foreign loans or till the military situation improved to assist credit. "But nevertheless, we shall start the next half-year with our devices exhausted, the American market congested with our issues, our account in debit and our gold reserves diminished by one-half at least".[20]

The question that faced Britain therefore was, the report continued, whether she could raise dollar loans as fast as she spent them. Between two loans the Treasury was living on over-drafts with their bankers which was growing heavier even as loans were being floated at smaller intervals. Soon, a time would come when the over-draft limit would be reached before a loan could be floated. The commitment of the American financial and industrial world to the Allied cause, though useful, cannot be relied upon, the report continued. It was beyond New York's capacity to undertake the whole burden of financing Britain which had therefore to look to the

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20 PRO T170/95, para. 12 of the **Report**.

states of the Mid and Far-West. Consequently, the lenders would not always get the orders that resulted from the loans.[21]

Responding to criticism of expenditure undertaken to maintain the sterling at her war parity the report added, probably at the insistence of the Bank of England, that the defence of the sterling was the "pivot of ... financial policy and the foundation of ... credit in all parts of the world" Unless this was done, funds and supplies could still be had but at a high price. Britain could get the resources she requires for an "efficient prosecution of the war" only if her credit was "unquestioned" and she could "maintain the appearance of having at (her) command a sufficiency of liquid resources".[22] In its summary the report recommended reduction of the British dependence upon the USA "in every way compatible with the efficient conduct of the war".[23]

This was easier said than done especially as the British government began to take in hand increasingly, procurement operations on behalf of her Allies, much of it against Britain's own credit to them. Thus, barely two months after the above report, Hardman Lever who was a member of the Anglo-French Financial Mission in New York prepared a Cabinet memorandum which emphasized Britain's continued need to raise funds in a reluctant US market. "Assuming that we withdraw **all gold**" from the Bank of England, the Treasury reserve and the Joint-Stock banks which totalled $700 million, and the Russian and French Governments gave between them $300 million as promised, Britain could meet her US obligations only for the next two months. "For March and later ... we must depend on supply of new gold

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[21] PRO T170/95, paras. 13 and 14 of the **Report**.

[22] PRO T170/95, para.15 of the **Report**.

[23] The summary is in PRO T170/95.

from Allies and any funds which may be raised from collateral and other loans".[24] The problem of British financing proved persistent and when the United States entered the war the latter's Treasury was "taken aback" by Britain's financial requirements.[25]

As we shall see later in this chapter, Britain's extraordinary commercial and financial dependence on the United States and the changes that this wrought for her financial position intrinsically and vis-a-vis the USA compelled her to finance her trade with India in a way so as to prevent gold exports to India. As we shall examine in the next chapter, she was also compelled to adjust the Indian economy after the war so that any deferred Indian demand for gold or liquidity might be averted. But first, in the section that follows, we proceed to examine India's trade and financial situation in the first world war as it concerns our analysis.

II.2 INDIAN TRADE IN THE WAR

India's trade surplus during the First World War was, remarkably, no higher than what obtained before the war. The average annual trade surplus over the 1914/1915-1918/1919 period was in fact, at 50.38 million pounds, lower than the

[24] PRO T172/379, Hardman Lever's Cabinet Memorandum of 21 December 1916. Emphasis in the original.

[25] PRO T170/324, Unsigned, undated memorandum dating from this period. Bradbury was probably its author. Of the total British war expenditure in the USA amounting to 2400 million pounds, some 850 million was financed through borrowing from the American government. Gold contributed 400 million pounds, of which half came from Imperial sources. Sales of dollar securities (200 million), market borrowing (296 million), British exports to the USA and the expenses of American troops in Britain made up the remainder. Cambridge University Library, Baldwin Papers 110, File 3b, draft reply dated 28 November 1932 to an US note; Gold figures from PRO T176/5, "Gold Held in the United Kingdom, 1914-1922", memorandum by Kitchin dated 22 January 1923.

corresponding figure for the previous five-year period (52.23 million). Moreover, the average figures for the war years concealed wide annual variations. The trade surplus in 1914/1915 was 29.11 million pounds - the smallest since 1908/1909. The largest trade surplus in the war years was 61.42 million pounds. This was not much higher than the pre-war peak of 59.51 million.[26]

The main reason why, despite strong demand for her exports and the reduction in her imports, the Indian trade surplus did not increase during the war (as for example was the case with the USA and Japan) was that the difficulties in financing combined to restrict exports to the essential war requirements of the Allies. Exports that were not related to the war effort suffered as a result. As well as its geographical orientation (Britain, USA and Japan increased their share), the manner in which Indian trade was financed changed considerably in the war years.

In the five years previous to the war, some 46% of the Indian trade surplus was liquidated by private imports of gold and silver. Gold accounted for the bulk of this movement - 80% of the total private import of gold and silver and some 36% of the entire trade surplus.[27] In contrast, in the war years, private bullion imports were down to some 14% of the total trade surplus, a large part of which was explained by gold imports from Japan in 1917/1918. Much of this gold began to figure soon enough in official Indian gold exports to the USA and Britain.[28] The

[26] IOLR L/F/7/612, Majority Report of the Babbington-Smith Committee, Para. 8; Appendix II to Memorandum A by Lionel Abrahams, Vol.2, p.8.

[27] Majority **Report** of the Babbington-Smith Committee, Para.8 and IOLR V/26/302/7, Appendix II to Appendix 3, McWatters' memorandum to the Hilton-Young Commission, Vol.II, pp.25.

[28] Indian gold receipts during the war were subject to close American and British attention. For example, the American Treasury sought an explanation from British officials for the observed increase in the gold held in the Indian Paper Currency Reserve over 1917-1918. See IOLR L/F/5/36, Reading to Foreign Office, telegram dated 26 April 1918 and HM Consul General in New York to Foreign Office, telegram dated 9 January 1918.

bulk of the surplus was therefore financed through council bills and official silver imports from the United States.

The principle was not fundamentally new. As we have suggested earlier, India's gold absorption in the pre-war years had led to protests from London bankers concerned about inadequate monetary gold reserves in Britain. It was known and welcomed in these banking circles that the India Office was selling council bills on India at less than the specie export point, and to an extent in excess of the budgeted amount and far in excess of "home charges" requirements. One of the reasons was "to undersell bullion dealers who may have an idea of importing gold into India". A "well known banking authority" - probably Edward Holden - was quoted as saying that council bills "should be sold freely and all available money lent out in London to keep the market easy there".[29]

When the war began however, there was nothing to suggest that there would have to be substantial council issues to finance Indian exports which, as we have seen, were quite low in 1914 and 1915. Besides, as the sterling was momentarily aided by the disturbed conditions in the world markets, London began to attract large inflows of gold.[30] The pound moved up in relation to the dollar from the pre-war gold standard parity of $4.86 to as high as $7 in August 1914 and settled down to around $5 late in September. For the rest of the year the pound was close enough to its dollar parity but nevertheless, in keeping with the trends in the world markets, there was a large demand for sterling in India which had to be met through reverse sales. Between August 1914 and January 1915, reverse council bills of the order of about 8.7 million pounds were sold. These were unprecedented amounts for what was a busy season in Indian trade. The pendulum swung in February 1915 when the

[29] The **Statist** dated 14 June 1913.

[30] Sayers, **The Bank**, 1976, p.78.

London demand for council bills revived. But the Indian Government's decision in April 1915 to finance wheat exports on its own account led to a fresh demand for reverse council bills as funds that had come to India to finance the wheat crop were repatriated to London. Reverse council bills of about 5 million pounds were sold over June-September 1915.[31] The net sales of councils in 1914/1915 was thus only 20.81 million. This was about two-thirds of net council sales in 1913/1914 and lower than the annual average over 1909/1910-1913/1914.

The real problems of financing Indian trade during the war did not appear until 1916/1917. Sales of council bills in that year totalled 32 million pounds against private gold bullion imports of 4 million pounds. But this one-sidedness in financing trade meant, (despite official silver imports of 127.5 million standard ounces during the year) that fiduciary issues against British Treasury bills bought out of the proceeds of council sales had to be increased.[32] By successive ordinances in November and December 1916, the Chamberlain Commission's Rs.200 million fiduciary limit had had to be relaxed and the investment component of the Paper Currency Reserve was increased to Rs.240 million. In the end, the limit on fiduciary issue was raised to Rs.1000 million.[33] The half-yearly figures for the composition of the Paper Currency Reserve in Table **II.1** below reflect the increase in the fiduciary element.

Indian holding of British Treasury bills in the Paper Currency Reserve increased from 4 million pounds to 55 million pounds between March 1916 and March 1919. This increase represented about 10% of the increase in the total volume of British

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31 IOLR V/26/302/7, Appendix 10, Denning's Note, Vol.2, p.75 and IOLR L/F/7/612, Qn.138.

32 Figures for council sales and private bullion imports as above. Official silver import figures from IOLR L/F/7/612, Memorandum A by Lionel Abrahams to Babbington-Smith Committee, paras. 6-8.

33 IOLR L/F/7/612, Howard's memorandum, Appendix D to Appendix I, p.31.

TABLE II.1 COMPOSITION OF THE PAPER CURRENCY RESERVE : MARCH 1914-SEPTEMBER 1919

Last day of	1	2	3	4
March 1914	661	47.8	31.0	21.2
Sept. 1914	605	19.15	7.7	23.2
March 1915	616	24.85	2.5	22.7
Sept. 1915	638	18.95	9.2	22.9
March 1916	677	35.83	4.8	29.4
Sept. 1916	716	32.03	5.8	32.2
March 1917	864	21.62	2.2	56.2
Sept. 1917	1084	16.02	7.3	56.7
March 1918	998	27.61	0.8	61.6
Sept. 1918	1344	15.3	20.7	64.0
March 1919	1535	11.4	24.4	64.2
Sept. 1919	1719	12.4	29.7	57.9

[Description: Col.1: Gross Note Circulation in Rs. million; cols.2,3 and 4: proportion to col.1 of gold, silver and securities respectively.]

Source: V/26/302/7, Appendix V to Appendix 3, McWatters' Memorandum to the Hilton-Young Commission, Vol.2, pp.28-31. The percentages may not add up to 100 because of rounding off].

Treasury bills outstanding in the same period. Needless to add, these official bill holdings were more stable than similar private holdings - an important advantage for the British Treasury when the latter was being embarrassed by the size of the Ways and Means Advances they were receiving from a reluctant Bank of England. The significance of the Indian holding of these bills when the latter were issued in such quantities to finance the war was therefore not lost on the Treasury. As Hawtrey remarked, holdings of these bills by the British clearing banks remained low during the war. Greater recourse to Bank of England advances was avoided because of alternate sources of demand for these bills. India was the most important source of this demand. Egypt was another.[34]

By December 1916 however, another problem began to raise its head. The fiduciary expansion provided by the ordinances had not only been exhausted but more importantly, the rupee coins in reserve had fallen to Rs.150 million, thereby endangering the ability of the Indian Government to convert notes into silver coin as it had found necessary to do.[35] Consequently, controls were imposed over Indian exports through restricting the availability of export financing. The latter was achieved by setting weekly limits on council sales. These sales were limited for the most part by the possibilities of buying silver and confined to the "chief exchange banks" and "firms of special eminence" . They were never enough to cover all exports which were therefore confined to specific requirements on an approved list.[36]

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34 SOASAddisPapersPp.Ms.14/393,"Banks'MonthlyReturns",memorandumby Hawtrey, May 1921. The source for Treasury bill holdings in the Paper Currency Reserves is the same as in Table **II.1** above. Treasury bill holdings in the Gold Standard Reserve varied between 6 million and 9 million pounds.

35 When we refer to the problem of rupee convertibility in this chapter and in the next one, we will be referring to the domestic rather than to any external convertibility problem.

36 IOLR L/F/7/612, Memorandum A by Lionel Abrahams, paras. 6-8; Report of the Babbington-Smith Committee, para.21. The rates at which the rupees were sold were not uniform as the rupee was revalued successively as silver prices rose. The

With restrictions on gold movements to India and the disruption of India's commodity imports resulting from the war, the normal channels of spending and saving of the Indian income-earner got effectively blocked. His liquid savings in the form of currency notes increased. His demand for silver rupees increased as he sought to move out of rupee notes which he trusted less than he did the actual silver coins. Strengthening this tendency and giving it the impetus of a rational portfolio switch was the increase in world silver prices whose effect was accentuated in India by controls on private silver imports designed to keep unofficial "purchasers on account of India out of the London and American markets".[37]

A major reason for the increase in silver prices was the fact that with restrictions on gold movements into India, a large part of the Western burden of financing the Indian trade surplus was transferred on to silver.[38] The Government of India bought 300 million ounces of standard silver in the market between April 1916 and March 1919 besides the 200 million ounces of silver purchased from the USA. In contrast, from April 1904 to March 1907 which was a reasonably stable period for Indian exports, the total Indian purchase for coinage was 180 million ounces, while private silver imports were in the region of about 133 million ounces.[39]

As silver prices increased or were expected to increase, the demand for silver rupees from the Indian Treasury offices increased. This demand is illustrated in

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weekly limits varied between Rs.3 million a week in September 1918 and Rs.12 million over the first half of 1917.

37 IOLR L/F/7/612, Lionel Abrahams Qn.71.

38 IOLRL/F/7/612,GubbayQns.323-324;LionelAbrahamsQns.33-34and1056-1059.

39 IOLR L/F/7/612, Report of the Babbington-Smith Committee, paras. 15-18. 1904/05-1906/07 figures from **Statistical Abstracts for British India,** Cmd.6017, 1911, Table 149, pp.166-167.

Table **II.2** below, by the reversal from August 1917 of the usual process whereby, in the slack season, silver rupees were returned to the Treasury offices.

It is evident from Table **II.2** that, starting from the middle of the 1917 slack season, silver rupees stopped coming into the currency offices and in 1918/1919 and 1919/1920, there was a positive demand for them even in the slack season. Partly, this change might be explained by a possible war-induced mitigation of the seasonal cycle but the major cause lay in the Indian house-holder's reluctance to return silver rupees at a time when, not only were silver prices rising but also, he lacked the spending or saving outlets previously open to him. Therefore, he began to demand silver rupees instead, against his currency notes. Although, through a process of rupee revaluation beginning in August 1917 and through controls on silver prices from April 1918, policy-makers in London, New York and Delhi made sure that the silver rupee would remain a token coin, the demand for them did not ease and gave rise to the single most important financial problem in India during the war. Tackling this required the combined resources of the British Government, the American Treasury and the Indian Government. Also the determination with which the problem was handled by Anglo-American cooperation established that the convertibility question was not a purely domestic one for India but, potentially, it had consequences that would have been damaging for the international monetary system at large.

For, convertibility in India was an unobtrusive lynch-pin in the pre-war gold standard. It helped keep the international system liquid by keeping the monetary demand for metal in India under check and diverting it towards silver. This was especially crucial when India's non-monetary demand for gold was already said to be absorbing some 30% of the world's new gold production.[40] Any event such as

[40] See in this connection J.Kitchin's statement of evidence to the Macmillan Committee, 1931, para.7.

TABLE II.2: ABSORPTION AND RETURN OF RUPEES AND NOTES : 1912/1913-1919/1920

YEAR	BUSY SEASON		SLACK SEASON	
	Rupees	Notes	Rupees	Notes
1912/1913	3242	- 23	-2120	244
1913/1914	3220	55	-2615	188
1914/1915	1914	- 979	-2536	672
1915/1916	2966	52	-2105	796
1916/1917	4927	914	-1578	870
1917/1918	3364	-1153	- 673	2733
1918/1919	2972	2682	1379	2548
1919/1920	1729	363	223	1962

[Source: IOLR V/26/302/7, Appendix 11, Vol.II, p.76.]

inconvertibility that could be expected to add to this pre-existing demand, it was feared, would have disastrous effects on the global liquidity position and was therefore to be averted.

Failure to preserve convertibility of the note issue was seen to have several consequences in the short-term and in the long-term. In the short term, procurement of war supplies in India was expected to be seriously affected and the prices of her exports to soar. It would lead to the withdrawal of Post Office and savings bank deposits, it was feared, and to a fall in the price of government securities. Recruitment in the Army would be affected. Working class disaffection and political agitation might also spread. But the more fundamental problems were expected to arise in the longer term. Once the government's credibility with regard to convertibility was undermined, it would be difficult to restore. It would, besides enhancing the difficulties of post-war resource mobilization, seriously hinder India's move away from precious metals towards paper money and securities and vastly increase her ability to drain the world's gold.[41] If Gubbay's account was from the periphery and betrayed a pre-occupation with its consequences for that area, the view in London on why it was important to avoid inconvertibility in India was somewhat more emphatic about the interests of the centre. Any development such as this, which restricted the use of notes in India, would be unfortunate not just for India but for "civilized countries generally ... It would be a sin against civilization ...." to allow it to come about.[42]

The significance of the convertibility question and London's fear that the periphery (Delhi) may perceive its importance differently from itself is highlighted in an

41 PRO T172/773, "The Probable Effects of Inconvertibility", memorandum by Mr.M.M.S.Gubbay, Controller of Currency in the Government of India. Also IOLR L/F/7/612, memorandum by Gubbay dated 23 January 1918 in Appendix II to L.Abrahams' Memorandum B. Vol.2, pp.84-88.

42 IOLR L/F/7/612, Abrahams, Qn.78.

exchange that occurred when Abrahams was giving evidence to the Babbington-Smith Committee. In his memorandum to the committee, Abrahams had implied that the Government of India was unmindful of the larger consequences of inconvertibility and were prepared to accept it light-heartedly.[43] Gubbay, who was an official in the Government of India as also a member of the currency committee, vehemently disputed this suggestion. He claimed that the Government of India took several steps to preserve convertibility against all odds. Firstly, extra-legal facilities for "encashment" such as were available through the District Treasuries were withdrawn. Besides, discriminatory council bill issues (so that they were available only for financing war exports) were made at the instance of the Government of India who also imposed restrictions on the movement of rupees by rail or steamer. He also referred to the Government of India using persuasion to avoid a run on the currency offices and characterized it as "inconvertibility by consent ...."[44]

The most novel measure according to Gubbay was the sale of gold by the Government of India which began in January 1917. About one million ounces were sold, most of which went up-country. But "really the effect of that sale was to give the up-country people something to spend their money on, with which they were familiar and which one knew they wanted." These sales also brought the premium on sovereigns down sufficiently to enable them to be released to finance wheat purchases. The total issues of sovereigns between April and August 1917 (the slack season) was Rs.116 million. Sovereign sales recommenced in February 1918 when convertibility pressures surfaced again.[45]

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[43] IOLR L/F/7/612, Memorandum B, para.8

[44] IOLR L/F/7/612, Qns.254-256 and 1196-1210.

[45] IOLR L/F/7/612, Qn.179. On gold reducing the demand for silver see also Qns.659-665.

However the Government of India's use of gold to ease convertibility pressures was halting rather than confident. The initial use of sovereigns was intended more to finance wheat purchases than to prevent a pressure on Government silver resources though the latter effect would have undoubtedly followed. There is evidence that in July 1918 the Indian Government asked the British Treasury for some assistance in the form of gold but in the end the assistance was not necessary.[46] However, as late as April 1919, Delhi was telegraphing London that there was no "immediate prospect of gold alleviating ... our difficulties" and that by importing gold, they would merely be "diminishing world's available stock of gold (as) ... sovereigns ... would serve no currency purpose after first issue .... Further supplies of gold are not, therefore, desired by us ...." The same telegram advised the continuation of import restrictions on gold.[47] Later in the Babbington-Smith Committee, Gubbay was at some pains to point out that this telegram expressed no opinion on non-monetary gold imports and only sought to prevent imports of sovereigns, though how this explanation squared with the advice to continue gold import restrictions was not clarified. At any rate, Gubbay attempted to have it taken off the record that the Indian Government did not desire gold.[48]

It is important now to stand apart from the details we have examined and summarize the argument. Unlike her trade with the United States during the war which was financed by means of gold and sales of securities and credits, British imports from India were financed largely by sales of council bills and the export of silver. The use of silver in India was intended mainly to prevent inconvertibility and the problems that it could create. In contrast to the American example,

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46 IOLR Mss.Eur.D523/2. Montagu to Chelmsford, letters dated 3 July 1918 and 21 August 1918.

47 IOLR L/F/7/612, Qn.1113.

48 IOLR L/F/7/612, Qns.1114-1117.

securities returned accounted in all for about 0.5 million pounds.[49] Nor did Britain raise any credits in India to finance her trade, though the Indian Government itself borrowed from the domestic market to finance her war-related expenditure. All Indian investment in British paper was therefore almost entirely from the official reserves, with the gold standard reserve by 1919 being entirely held in the form of British securities.[50] As we examine in the next chapter the bulk of the war time-sterling investments in the Paper Currency Reserve were adjusted away during February - September 1920. Gold accounted for an insignificant part of the Indian financing in the war years. The absence of gold and the disruption of commodity imports increased the pressure on the silver resources of the Government of India and threatened the convertibility of the Indian note issue into silver rupees.

Asked in the Hilton-Young Commission some years later about the reason for Britain not financing her imports from India through credits, Kisch replied that Britain had raised credits in USA because "she was forced to do it." By doing so, Britain acquired a serious future obligation. India would not have been in a happy situation if she had merely established a large debt to her from the rest of the world. She would then have been at the mercy of her debtors.

This was strange logic coming, as it did, from an official in the government of a

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[49] Government of India, **Report of the Controller of Currency**, 1917-1918, para.9. Also Angus Maddison, "The Historical Origins of Indian Poverty", **BNDLQR**, No.92, 1980, pp.53-54, who points out that India, unlike other less developed countries at the time, did not reduce her debt in the war. We have not dealt at any length on the 150 million pounds contribution to the British war effort that the Government of India made, because the contribution was political and secondly, rather than liquidating the Indian current account surplus in the war, this was an addition to India's long-term external capital liabilities. This was a small bone of contention when negotiations took place in regard to India's sterling balances in 1947! IOLR L/F/7/2868, "Government of India's Debt to the United Kingdom Government Arising from the 1914-1918 War", undated memorandum by K.Anderson attached to Government of India, Finance Department note dated 11 February 1947.

[50] IOLR L/F/7/612, Appendix D to Appendix I, Vol.3, p.29; memorandum by Howard dated 20 May 1919, para.5.

country with large overseas credits. Secondly, the reply did not take into account the manner in which the sterling investments in the Paper Currency Reserves (which were also liabilities of the British government) were liquidated in 1920 and the fact that had larger and longer credits been raised in India in the war, there may have been fewer imperatives for a severely deflationary stabilization policy in India after the war ended. Thirdly, the argument was inconsistent with the other steps that British financial policy in India had been seeking to encourage (and which at that very time Kisch and the India Office were urging on the Commission to adopt) : the increased use of paper currency, increased key currency investments in the reserves and a reduced dependence on metallic currency. Kisch's explanation was also contrary to the declared aim of expanding the Indian banking system and developing a market for financial assets in India. Further he ignored the fact that the possibility of returning India's sterling liabilities, much as dollar securities were returned in the war, was never considered. Lastly, Kisch ignored the depreciation of silver in the reserves of the Indian government and the Indian private sector and the fact that India was now at the mercy of silver - a constraint that was affecting the freedom of Indian financial policy at that very moment and was similarly to constrain it over the next few years.

Asked in the same commission about the causes for the non-availability of gold to India during the war, Kisch again replied with the bureaucrat's characteristic mixture of bombast and half-truth. "When the Empire was involved in a life and death struggle ...." he said, "it would not have been in India's interests or consistent with the place she occupies in the Empire for her ... under these conditions ... to demand gold. That gold was required for conservation and for use in countries which were not our allies".[51] The half-truth lay in the fact that the USA was a British ally in the war from April 1917 and Britain needed America to

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[51] IOLR V/26/302/8, Qn.11050.

possess gold not only because the latter would not accept sterling credits but also because,Britain needed to preserve her credit in that market. Besides, the threat of inconvertibility in India, which derived essentially from the reduced role of gold in liquidating Indian surpluses, enabled Britain and the United States to switch the demand of one important segment of the periphery away from the primary reserve, to an inferior form of liquidity (silver), when the centre was experiencing a liquidity crisis and a strong demand for the exports of the periphery. The manner in which this switch was accomplished is the subject of the next section.

II.3 THE PITMAN SILVER AGREEMENT

Allowing New York to possess gold meant among other things restricting US gold exports to India except in so far as Indian gold receipts could be used to help avert inconvertibility. When the American Ambassador in London complained that despite the great demand for India's exports in the USA, importers were unable to transfer money to India "owing to the restrictions on exchange imposed by His Majesty's Authorities ..." and sought some arrangement to enable the financing of US imports from India, the British Treasury jumped at the opportunity.[52] The Treasury suggested to the India Office that as it would be difficult to control the use of rupees if shipment of gold was left in private hands, the latter should agree to furnish rupee exchange to the American authorities exclusively for the import of national necessities, against delivery of gold to Indian government agents at San Francisco.[53] It is significant therefore that the initiative regarding the manner in which rupees would be furnished to US importers came not from the latter's own government but from the British Treasury. The India Office complied.[54] Similarly, the first moves to reduce Indian gold receipts from America also came from the British Treasury. It asked the British Consul General in New York to urge the Americans to limit their imports from India to articles of national necessity, "thus diminishing the need for the export of gold from the United States to India ...."[55]

In his communication, the American Ambassador had not ruled out gold exports to India as a means of financing US imports from her. Likewise, other importers were

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[52] IOLR L/F/5/36, US Ambassador in London to the Foreign Office, letter dated 31 May 1917. Unless otherwise stated, all the references in this section are to this file.

[53] Treasury to India Office, letter dated 18 June 1917.

[54] India Office to Foreign Office, letter dated 19 June 1917.

[55] Foreign Office to HM Consul General in New York, Telegram dated 20 June 1917.

prepared to export gold to India, if necessary, to procure India's exports. Once again the Treasury intervened and as the Secretary of State informed the Viceroy in Delhi, "... in accordance with the urgent requests of the Chancellor of the Exchequer, and in order that Imperial interests of primary importance may be protected", enquirers were being informed that "shipments of gold from London without the approval of the Treasury or from America without that of the United States Government or of the Federal Reserve Banks are not in the public interest."[56] The same telegram asked the Indian Government to procure for itself all gold landing in India.

It should be clear therefore that controls on gold imports into India preceded the American embargo on gold movements (Britain did not formally check gold exports until March 1919) and reflected a British concern rather than, as yet, an American one. American protests at having to export gold to India were to emerge later in the context of her official war credits to Britain. The British aim in seeking to prevent gold movements from the United States, as we have pointed out in an earlier section, was to keep the markets in the latter country liquid and enable her loan issues there. Therefore the British move reflected not so much a global liquidity shortage yet as it did a British one.[57] But simultaneously, American requirements from India had to met especially if these were inputs into British war imports from the United States. The American demand had to be satisfied without increasing substantially the prices of imports from India or causing large gold outflows to her. The fact that aborted gold flows when India was meeting huge export orders would hasten a convertibility crisis was another reason why imports from India had to be curtailed.

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[56] Secretary of State to Viceroy, telegram dated 19 June 1917.

[57] Henry Clay, **Lord Norman**, 1957, p.89.

As Abrahams clarified in his testimony to the Babbington-Smith Committee, the requirement that all gold (or silver) brought to India should be sold to the Government of India was the "outcome of discussion with the Bank of England and the authorities in this country". The rate which the authorities in India were allowed to offer for the gold was the product of a compromise. The India Office would have preferred better terms "but there were authorities in this country who thought, reasonably enough, that the central needs of the Empire ought rather to be considered ... fixing a price was very largely governed by the desire to be fair to India and at the same time, fair to the rest of the Empire."[58] Despite its "fairness", this price was too low to enable India to get much gold. Indian government representations to London to allow higher prices were met by the Treasury view that they were not "proper".[59] Besides, the Exchange Banks complained that at the prices that they were allowed to offer, they could get no gold.[60]

By September 1917 when the United States imposed checks on gold and silver, there was growing American disquiet, not over gold exports to India **per se** but, over the need to simultaneously finance British purchases from the USA through credits and loans as well as ship even limited quantities of gold to India to buy her exports. The British Ambassador in Washington telegraphed the Foreign Office to say that it would be politically useful if Britain could reciprocate the dollar advances she received from the USA with credits to enable the latter to import from India. In any case, because of her entry into the war and the large dollar credits she had made to Britain, it was felt that the USA might not license more gold exports to

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58 IOLR L/F/7/612, Qn.71.

59 IOLR L/F/7/612, Meyer, Qn.3323. Meyer had been the Finance Member of the Government of India in the early years of the war.

60 IOLR L/F/7/612, Qns.2891-2898 and Lionel Abrahams, Qns.1246-1254.

India although it may furnish silver against specific import requirements.[61]

In the explanations that they gave to the Anglo-French Financial Commission in Washington for their unwillingness to ship gold to India, the American authorities also issued a scarcely veiled threat to stop supporting the sterling if India insisted on gold. The Americans said, given large US credits to Britain, the need to export gold to India - a "British possession" - to procure imports for the "prosecution of the war" was turning opinion in "influential Government and business circles" against "upholding the sterling exchange." The USA had imposed a gold embargo to enable the Allies to borrow in that market. South American exporters were being asked to export against dollar credits and if India were to issue rupee credits against dollar deposits at the Federal Reserve, an useful precedent would be set especially for South America, and the criticism of the combined system of "British loans and gold shipments to India that is now causing friction will be eliminated to great mutual advantage (of) England and America". If this was done, the communication promised, the USA would operate its silver embargo in such a way that silver prices were kept at the mint parity of the rupee. Suggesting a $10 million rupee credit line at the Federal Reserve by January 1918, the telegram stated, "this action promptly taken will help gold reserve and maintenance of sterling exchange (in) this market and good feeling in this country."[62]

Communications such as these prompted the India Office to tell the Government of India, in the clearest admission yet of the triangular context in which India was denied gold in the war, that USA's reluctance to ship gold to India arose because

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61 Telegrams dated 18 September 1917 and 25 September 1917.

62 "Telegram drafted by the US Authorities and Submitted to Sir H.Lever". This telegram was not sent through the usual channels but on his return from the USA in October 1917, Keynes handed over a copy of it to L.Abrahams. Similar views were also officially conveyed. See Ambassador to Foreign Office, telegrams of 18 and 25 September 1917.

she was granting large credits to Britain to finance imports from the USA while Britain was not yet reciprocating by issuing rupee credits. The India Office sought Delhi's views on the American willingness to sell silver. The latter regretted that no gold would be available but agreed to provide rupee credits to the USA.[63] The India Office consequently suggested rupee credits to the USA of Rs.30 million ($10.5 million at 33.5 cents per rupee) to import articles of primary war importance on the condition that the dollars so earned should be liquidated against gold or silver delivered by February 1918. The US authorities could, at their option, postpone conversion by loaning silver but the credits were to be granted subject to the condition that the US government issued licenses to enable export of gold bought in the USA by the Secretary of State.[64]

But far from allowing India to procure gold in the USA, the US government had begun to suggest that some of the gold in the Paper Currency Reserve be used to buy silver from them. The initial London response was to regard this as an unacceptable arrangement especially because it would not replenish the Indian reserves.[65] In January 1918 the US Treasury returned to their demand for gold in return for silver. They suggested that US advances to Britain were enabling the latter to buy silver for India without placing rupee credits in the USA. They argued that the USA had to buy Mexican silver in return for its own gold. A telegram from the UK Treasury representative in New York warned London that US Treasury officials in their conversations, were again talking of the gold in the Indian Paper Currency Reserve and that a request to place this at US disposal "as a condition for the continued purchase of silver for India out of United States dollar

63 Secretary of State to Viceroy, telegram dated 28 September 1917 and Viceroy to Secretary of State dated 2 October 1917.

64 Foreign Office to HM Ambassador, telegram dated 26 October 1917; Secretary of State to Viceroy, telegram dated 25 October 1917.

65 Foreign Office to HM Ambassador, telegram dated 26 October 1917.

advances" may soon be made.[66]

Indeed, barely a week later, the Foreign Office received a US Treasury memorandum which said that given the importance of "strengthening gold reserve of United States to (enable) carrying out of its larger loan operations, which is in the interests of all allies ..." the Government of India should earmark to the Federal Reserve through the Bank of England "a substantial part of the gold now held" in the Paper Currency Reserve, receiving in return credits to buy silver. Besides, against silver released under a legislation which was the subject of negotiation at that time between the British and American governments, the US wanted rupee credits of 165 grams fine silver rupees.[67] The British Consul had responded to the US gold demand by telling the latter's Treasury that the question could not be considered solely as "an Indian question, but also from (the) broad stand-point of use made by British Government of its gold resources". But there were limits to this argument, he reminded the Foreign Office in London because, for tactical reasons "in discussions of the rupee question stress had been laid on separateness of India and British Governments ...."[68]

But by now, the Government of India, desperate to prevent inconvertibility, had begun planning to reduce conversion demands by offering gold in return for notes and sending gold out to finance harvest procurement. The government, clearly, could not spare the gold unless substantial silver arrivals from the USA relieved convertibility pressures.[69] Here, matters rested for a month though in the

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[66] HM Consul General in New York to Foreign Office, telegram dated 9 January 1918.

[67] HM Consul General to Foreign Office, telegram dated 18 January 1918. We will return shortly to the questions raised by the latter part of the communication.

[68] HM Consul General to Foreign Office, telegram dated 18 January 1918.

[69] Viceroy to Secretary of State, telegram dated 28 January 1918.

meanwhile details were settled between the India Office and the Treasury, to earmark Indian gold for the US account.[70]

The US government returned to the theme late in February 1918. The reason now offered was that if the Government of India agreed to earmark gold, it would ease passage in the US Congress of a projected legislation enabling the release of US Treasury silver reserves for sale to India. Lord Reading who was negotiating the deal on behalf of the British government, was impressed by the argument and he added that the US was also anxious to strengthen its gold reserves to launch a war loan. He promised to seek to restrict the amount of gold that the US government could get - he suggested in consultation with Brunyate a figure of 5 million pounds which the latter thought India could spare - but sought the power to make the offer. In return he said the Government of India would be able to get 150 million ounces of silver from the US mint besides silver against gold transfers.[71] On being assured by Reading that the Federal Reserve wanted gold only earmarked and not shipped, the India Office gave him the necessary powers on condition that the offer should be contingent on larger silver availability and silver price being $1 per ounce.[72]

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[70] India Office to Treasury, letter dated 25 January 1918 and Treasury to India Office letter dated 31 January 1918.

[71] Reading to Foreign Office, telegram dated 27 February 1918.

[72] Foreign Office to Reading, telegram dated 3 March 1918. The USA was not alone in seeking payment for silver partly in gold. The British Treasury shipped some silver to India in March 1918 for one half of which she sought payment in gold. For the other half she sought rupee credits. In the event, the deal with the USA was rather more favourable from the standpoint of the Government of India's gold reserves. Only a quarter of the silver was to be paid for in the form of gold; see Secretary of State to Viceroy, telegram dated 6 March 1918. In another interesting case, the British Treasury asked the India Office to settle in dollars for the silver the former had bought on the latter's behalf. The India Office managed to dissuade the Treasury from sticking to the idea; see Chalmers to Lucas, letter dated 13 May 1918, Montagu to Chancellor of the Exchequer, letter dated 26 July 1918 and the reply from the Treasury dated 31 July 1918. It is clear from these examples that, in the war, Britain did not want India to make demands on the dollar earnings of the sterling area or reduce its capacity to earn dollars even while

These demands for gold against small silver releases were taking place even as protracted negotiations were being conducted between British government representatives in New York and the US Treasury over the manner in which the latter could release a substantial portion of her silver reserves to meet India's needs, and the conditions surrounding such releases. The India Office was convinced fairly early that only the USA had the silver resources that were now needed to finance trade and preserve convertibility in India and had proceeded to accept suggestions from New York that granting advance rupee credits would help ease the path. From time to time during these negotiations the India Office authorised credits which by April 1918 had amounted to Rs.40 million.[73]

The silver question, even at the best of times, was a controversial one in the USA. It was even more so in the context of a British or Indian demand for silver. US silver interests had been severely affected by India going off silver in 1893. They could do little as they watched the silver rupee turn steadily into a token coin with the bulk of the resultant coinage profits being put at London's disposal. Reading understood the passions and controversies that silver aroused in the USA. He was therefore keen that the silver legislation required to enable the melting and export to India of silver one-dollar pieces in the US Treasury reserves, should not be projected as having been actuated by British or Indian interests.[74] But silver interests on both sides of the Atlantic knew as early as November 1917 that the "only buffer to protect our Western gold reserves against the Indian drain (was) a silver buffer ..." and also that, the only consideration that may restrict silver prices

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she was expected to contribute substantially to it. A similar dispute arose in the second world war and was less easily resolved; see IOLR L/F/7/2868.

[73] Reading to Foreign Office, telegram dated 10 February 1918; India Office to Viceroy, telegram dated 17 January 1918 and periodical credit statements on file.

[74] Reading to Foreign Office, telegram dated 21 March 1918.

during the war was the concern to prevent an undue appreciation of the rupee when war made demands for India's exports somewhat inelastic.[75] Already, the protests of the US silver producers had compelled the New York Federal Reserve to take up with the British government the question of silver price controls in London. While the USA had imposed controls after entering the war, London had no formal controls. As such, the Federal Reserve suspected, the British government was being enabled by dollar credits to outbid the former in US silver markets.[76] Therefore they insisted that the London price of silver should be fixed at the US monopoly purchase price of the metal and after some hesitation the British Treasury agreed.[77] Secondly, the US silver interests, memories of India deserting their metal still fresh in their minds, were keen to prevent a continuation of the process whereby the profits of coining one rupee tokens - which they estimated at $125 million - were being lent to the British government. The increase in the Indian demand enabled them to raise the price of silver and to choke off these coinage profits. They insisted on a silver price of one dollar per ounce which corresponded to a 18d. rupee and which would give them great gains and little profits to authorities in London and Delhi.[78]

The Governor of the New York Federal Reserve had already shown an interest in the alleged disposition of the British government to profit from silver coinage in India.[79] The US government also took the view, after the necessary silver

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[75] Morten Frowen in the **Financial News** dated 19 November 1917. Frowen was considered by the India Office to represent silver interests. See IOLR L/F/7/603, Montagu to Crewe, letter dated 13 May 1919.

[76] HM Consul General in New York to Foreign Office, telegram dated 13 November 1917 enclosing a letter from the Governor of the New York Federal Reserve; also telegram dated 9 January 1918.

[77] Secretary of State to Viceroy, telegram dated 9 January 1918.

[78] "Confidential Letter of a Well-Posted American in Washington", on p.36 of IOLR L/F/5/36.

[79] HM Consul General to Foreign Office, telegram dated 13 July 1917.

legislation had been passed in the Congress, that they could not be "expected to pay more for rupees than they actually cost" and insisted on the rupee-dollar parity being fixed with reference to the price of silver.[80] In effect then, the US managed if only briefly to put India on an effective silver standard.[81]

In the event, the silver legislation that was approved by the US Congress enabled the US Treasury to melt and ship to India at least 150 million ounces of silver at $1 per ounce, a quarter of which was to be paid for in gold. The deal was highly favourable to the US Treasury and the US silver interests. India paid one dollar per ounce when the ruling price before India's needs became known was 68 cents.[82] The silver dollars which were melted down by the US government were of no use to the latter and were in fact a charge on their gold reserves. The silver was also depreciating in value and "there did not seem to be any way to realize whatever value it did have, until along came this enormous demand for silver for settlements with India in 1917-1918...."[83] It was left to India to sustain enormous losses on her silver reserves over the next decade and a half.[84] However in 1918, the India

[80] Reading to Foreign Office, telegrams dated 26 April 1918 and 6 May 1918; Bayley to Foreign Office dated 23 April 1918.

[81] IOLR L/F/7/612, Lucas to Babbington-Smith Committee, Qn.4000.

[82] IOLR L/F/6/169, "Silver Supply, Demand and Prices", memorandum by J.Kitchin dated 25 February 1931.

[83] IOLR V/26/302/8, George E. Roberts to Hilton-Young Commission, Qn.15099. Roberts was an American banker.

[84] PRO T160/8, F.260/3, "Pitman Silver", memorandum by Bowley dated February 1933. Bowley seems to suggest that the losses were incurred by the British Treasury though Bowley may have been referring to the dollar payments of the sterling area taken as a whole. The former was not a valid suggestion because the losses of the British government were confined to the exchange losses on the deal in that it was contracted when sterling was at $4.765 while some of the repayment was made when the pound was lower. In fact part of these exchange losses were made good by the Indian Government; see PRO T160, F.260/2, India Office to Treasury, letter dated 11 December 1919, Niemeyer to Lucas, letter dated 24 January 1920 and Lucas to Niemeyer, letter dated 27 January 1920. The actual capital loss (estimated by Bowley at 50% of the value of the silver bought in 1918) was sustained by the Indian government and the Indian holder of silver.

Office was willing to pay the one dollar price in order to avoid inconvertibility in India. It considered that the US judgement regarding the price of silver could be relied upon despite the powerful influence of the silver interests in the administration, since the US government "so far as it uses silver for the purposes of its own Mint and to obtain credits in India for American purchases, will have a principal interest in the price ... (and therefore) ... it will ... show a due regard for cheapness when bargaining with American producers ...." Hence, if silver could be procured in sufficient quantities to avert inconvertibility in India only at a price of $1 per ounce, the Indian government was willing to pay the price fixed by the US government.[85]

In the small print it was conceded that, should silver prices fall during the period of the agreement, the rupee would move down in sympathy. Thereby, USA underlined the fact of the rupee being effectively on a silver standard. More importantly, there is evidence that the United States sought and the British government gave a guarantee that as long as the war lasted, the rupee would not be revalued beyond 18d.. The desire to deny silver coinage profits to the British and Indian governments is not a sufficient explanation for this explicit guarantee as it was already secured by the agreed link between silver prices and the dollar price of rupee credits. The wish to see the US dollar emerge as a desirable asset played a part. But the most important consideration seems to have been the wish to reduce the costs of imports from India, as the India Office recognized.

Throughout our discussion of Indian trade during the war that was carried out in the last section, we have omitted to consider the revaluation of the rupee. This neglect was intentional. Rupee revaluation was resorted to during the war, not in the context of India's trade disequilibrium or to tackle domestic inflationary

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[85] "Negotiations for Obtaining Silver from America for India", note for Lord Reading on p.45 of IOLR L/F/5/36.

pressures but as an inevitable accompaniment to the increase in world silver prices and as part of an effort to reduce demands on the Indian government's silver reserves. In fact, in the first three years of the war and till the rise in silver prices made it impossible, London authorities saw the preservation of the pre-war rupee parity of 16d. as a necessary Indian sacrifice undertaken in order to enable the British government to procure her imports from India more cheaply. This rate, as an India Office memorandum put it, "was only abandoned under the pressure of irresistible influences ... successive rises were delayed as long as possible and by their action the Indian Government facilitated the purchase on favourable terms of supplies of foodstuffs and war materials required for the conduct of the war".[86]

Therefore, the American request that the rupee should not be revalued beyond the rate suggested by silver prices was presumably quite welcome to the British government. The Americans made no bones about why they wanted a stable rupee during the war. As an American official clarified to Blackett when the latter complained about the difficulties of procuring enough silver after the war was over at the prices allowed by a 18d. rupee, the British "undertaking to keep the exchange rate in New York at 35.73 was limited in time to the period of the war, and indeed to war requirements."[87]

Once again it is necessary to stand back from the details we have examined in the course of this lengthy narration and get to the heart of the argument. The above narration has been necessary principally to emphasize the fact that the traditional

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86 PRO T160/550, F.7219/1, "The Position of India in regard to an Imperial Currency System", India Office memorandum dated 26 April 1920. The memorandum went on to argue that with the war over, India had to be protected from the evils of inflation and hence it was necessary to revalue the rupee substantially. We proceed to take issue with this interpretation in the next chapter.

87 Blackett to Lucas, letter dated 14 March 1919. A rupee-dollar parity of 35.73 cents corresponded to a rupee-sterling parity of 18d.. There is also other evidence that the prices of Indian exports worried the USA. See for example, Reading to Secretary of State, telegram dated 7 June 1918.

explanation for India's inability to secure gold in the war against her exports - that "belligerent countries" imposed restrictions on gold movements or that shipping shortages prevented gold from being moved - is less than the whole truth. Logically, it is difficult to square the traditional explanation with the view expressed even after the war that there was potentially a limitless demand for India's exports at any price, unless we postulate a degree of extra-economic coercion or persuasion. Consider in this context Kisch's suggestion we have recalled earlier that the Americans had refused to accept sterling paper and had forced the British to import against dollar credits. India could not secure gold in return for her exports during the war because of the certainty that her exports, no matter how crucial to the war effort, could be financed without it. Nor does the traditional view allow for the significance of the liquidity battle that was taking place between the United States and Britain - both allies in the war - and the effect of it on liquidity entitlement on the periphery. In other words, India's subordinate position as a colony meant among other things that when the countries at the centre were facing a liquidity crisis, India would have to settle for a reduced share of liquidity. Besides she had to accept relatively less liquid media like sterling bills which was now not quite "good as gold" or silver, till such time as the Indian liquidity demand could be adjusted away. In fact, in a different context fifteen years later, the British Treasury admitted the validity of the above interpretation. Reacting to an American proposal in 1932 that central banks should help increase silver prices by holding more of the metal in their reserves, a Treasury memorandum said "the suggestion is ... put forward usually as a device for alleviating a prospective shortage of gold or the existing mal-distribution of gold."[88]

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[88] PRO T160/488/F.13017/4, "Some Aspects of the Silver Question", draft financial memorandum prepared jointly by the India Office and the Treasury for the World Economic and Monetary Conference, para. 6(ii). By now of course, with the sterling no longer nailed to gold, the freedom of policy that Britain derived vis-a-vis the USA and the weakening of internationalist views in the depression was reflected in Whitehall memoranda. For example, British views on the 1918 silver deal underwent major changes between 1926 and 1932.

But a more interesting puzzle is why - apart from the need to avert inconvertibility - it was necessary to settle India's balances in silver. Undoubtedly, inconvertibility was a major threat which in the short-run would have jeopardized the financing of war exports and in the long run, caused a set-back to the development of the note issue in India and consequently necessitated an increase in official metallic reserves and private metal hoards. But there were other ways in which excess liquidity could have been mopped up and the threat to inconvertibility averted, such as the flotation of sterling loans, as Indian economists and businessmen had proposed. The undeveloped nature of the Indian financial system and the inexperience of the average Indian in regard to financial assets might have been one reason, though this does not fully explain why no attempts were made in the war to promote a market for securities. The unregulated conversion possibilities created by a mass of small holders who had a marked propensity for gold is another explanation that suggests itself. This was clearly how the Americans saw the deal at that time, as the US Treasury Secretary who helped finalize it explained to Sen.Pitman. After talking of huge surpluses run up by India, he said the "Orient" was "willing to accept silver in place of gold for the commodities furnished by them" and it was in the US interest to have these balances settled in silver rather than gold. "The gold in this country and in the hands of the Allies is needed as a base for the enormous credit it is necessary to erect ... and every ounce of silver that can be used for settlement is ... so much gained." Further, he pointed out that to ship silver was preferable to "stabilizing exchange" because silver now meant a definite settlement while exchange arrangements "always meant a deferred demand for gold."[89]

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89 McAdoo to Pitman, undated letter. This is an annexure to Reading to Foreign Office, letter dated 22 July 1918. Testifying to the Hilton-Young Commission some years later, the New York Federal Reserve delegation made a similar point. See IOLR V/26/302/8, Qn.15311, Sprague's statement, part 2.

II.4 CONCLUSION

To continue posing the question as one of potential or aborted gold flows is to court confusion. Firstly, one risks getting drawn into polemics that characterized the question at that time and more recently. Secondly, neither the denial of gold to India nor the demand for it by the "Bombay" spokesmen, arose from mercantilist notions or some primitive fancy for the metal. Gold was even more important to the liquidity of the war and post-war economies than it was to the pre-war one. In the war and post-war international economy, India's liquidity problems arose from British willingness and ability to adjust India's liquidity demands (or supplies) to her own needs especially as the latter were affected by the constraints on permissible domestic deflation. If as a consequence, India's asset portfolio got switched in barely justifiable ways or her monetary policies suffered from a deflationary bias, these were mirror images of policies designed to keep Britain liquid or postpone, if not avert, necessary deflation in Britain. This imaging was to last throughout the inter-war period and was to come into its own during the depression.

By itself, the asset switch forced on India should not have been of great significance if its duration and effects had been confined to the war years. But the desire to avert a deferred move away from silver and towards gold was the source of the deflationary policies followed after the war when control on metallic flows could no longer be justifiably imposed. To avert or postpone her primary liquidity demands after the war, India had to be subject to deflation.

India had been put on gold (even as care was taken to ensure that she would not set up an unmanageable strain on its availability) when it was not expected that the growth and distribution of world trade would, within a matter of years, lead to a gold shortage in important trading areas of the world. But the simultaneous growth of gold appetites in the USA and India and the sterilization of gold receipts in both countries in different degrees and ways were merely the most visible symptoms of a shift in the distribution of world liquidity. This shift derived in the US case from more permanent causes leading to a shift in the balance of economic power and in the Indian case, from a temporary though not brief period of strong demand for her primary exports. What made matters worse from the British point of view was that one of the gold holders (USA) was not willing to hold her reserves in sterling assets. The other gold hoarder - India - could yet be financed in a way as to reduce her demand for world liquidity and be adjusted in a manner as to reduce any residual deferred danger she might pose to Britain's liquidity position. The financing of Indian trade in the war was designed to minimize the strain on the world's primary liquidity reserves and has been examined in this chapter. The Babbington-Smith Committee proceeded to ensure that a deferred (post-war) liquidity demand by India would be averted. The stabilization package prescribed by this committee and its motivations are discussed in the next chapter.

CHAPTER 3

Adjusting the Indian Liquidity Demand:

The Stabilization Package of 1920

As we have seen in the last chapter, India emerged from the First World War with large sterling balances in her Paper Currency Reserve. Besides, she was also to get, in the next few years, substantial disbursements from the British War Office against her war expenditures on the latter's behalf. These would have constituted a further addition to her external balances. In many respects however, the external account was less healthy than it appeared. There was an accumulated demand for consumer and capital goods, the imports of which had been disrupted by the war. There had also been checks on the imports of gold and silver, which resulted in a domestic premium on these metals. Further, private transfers out of India had either been delayed or postponed to take advantage of the profitable investment conditions created by the war and the cessation of the flow of private capital.

One outcome of the First World War in regard to the political-economy of balance of payments adjustment was the movement towards the rejection of the notion, accepted unquestioningly hitherto, that the onus of payments adjustment rested on the deficit countries. The debate on the sharing of adjustment burdens between surplus and deficit countries has continued to this day, with each set of countries expecting the other to bear the necessary costs. After the First World War, for the first time, powerful countries (including Britain) were beginning to face payments disequilibria, and they were better placed to demand a distribution of adjustment burdens than the weaker deficit countries before them.

Countries which are unimportant players in the international financial system and which are in deficit have always had to bear a dis-proportionate adjustment responsibility if only because the financing of those deficits could be regulated, almost at will, by the more powerful surplus countries. But the British resistance to domestic deflation after the war and its desire to promote American expansion did not represent the only departure from this tradition. India, despite its surpluses, was forced to undertake severe adjustment action to relieve liquidity pressures at the centre. However on account of features peculiar to India, the nature of the adjustment process here differed significantly from what Britain expected other surplus countries to follow. As countries in surplus adjust away their dis-equilibrium, they would augment, in some degree, growth and liquidity in the deficit countries by relaxing the payments constraint on the latter's expansion. An increase in domestic prices, incomes and economic activity are the normal ingredients of an adjustment process in a country with an external surplus. Britain expected the USA to adjust in this way. In the Indian case however, the adjustment process to ease Britain's liquidity crisis was designed to be deflationary.

Given the nature of Indian reserve demands and the contra-cyclical asset-demand or release function in relation to the international monetary system that commentators had long assigned to India, the nature of the Indian response to its external disequilibrium should not come as a surprise.[1] In the post-war case however, the contra-cyclical role was mainly induced by short-term policy. The making of this policy in the Babbington-Smith Committee and a survey of its consequences as it affects our study are the subjects of the present chapter.

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[1] The best known work in which this is recognised is **JMK**, Vol.1.

This chapter is organised as follows. The first section studies in some detail the motivations behind the stabilization policy recommended by the majority report of the Babbington-Smith Committee through an examination, primarily, of its proceedings. The first part of this section discusses the so-called convertibility argument for a rupee revaluation while the second part looks at the inflation argument. The second section recounts the response of the British Treasury to the committee's report and its successful efforts to modify the operative portions. The third section discusses the outcome of the 1920 stabilization attempt as it affects us, while the last section attempts to bring together the essential points of our argument in this chapter and the previous one.

III.1 THE BABBINGTON-SMITH COMMITTEE

The Babbington-Smith Committee was asked to examine the effects of the war on the Indian monetary system and, in the light of the expected movement of silver prices, recommend modifications to the pre-war system with a view to ensuring a stable gold-exchange standard. Its Chairman Henry Babbington-Smith was a member of the Anglo-American Finance Commission in New York set up to handle the financing of the war in the United States. As such, he could have been expected to be familiar with the larger ramifications of any stabilization policy that was prescribed for India. Its other important members also represented significant financial interests. Charles Addis played an important role both in the recorded deliberations and behind the scenes.[2] He was a Director of the Bank of England. Addis had served on the Cunliffe Committee which recommended an early British return to the gold standard. He had also been on the Inchcape Committee which was constituted in October 1918 to report on the effect of the war on the gold production of the British Empire and on measures to stimulate it. As some one who

2 SOAS Addis Papers Pp.Ms. 14/57, Diary entry of 21 November 1919.

had acquired his professional banking experience in China, Addis could be expected to be familiar with the silver question as it affected important interests. Further, he had campaigned, even as the Babbington-Smith Committee was hearing evidence, to publicize the relatively novel argument that post-war European reconstruction should be financed largely by countries whose "trade balances and ... exchanges were favourable".[3]

The significance of the new committee in contemporary perception is evident from the interest that it evoked. In response to a Parliamentary question about appointing members who would represent the "manufacturers", the Secretary of State Edwin Montagu replied that he hoped to make such an appointment. The India Office thought that Needham, a former Manchester M.P., represented "staple export" and that he was adequate to represent Manchester.[4] Another question reflected the principal concern of the London financial establishment in this period, though it postulated a non-existent conflict between British home firms and exporters. Richard Cooper asked the Prime Minister if the "desire of the British home firms to be included on the proposed Commission ... in order to review the policy of allowing India to drain gold from Europe ..." will be matched by the appointment to the committee of two members representing manufacturers and exporters. The Prime Minister, while not denying any of the implications raised by the question, replied that Mr.Needham would represent those interests adequately.[5]

Before we discuss the deliberations of this committee, we will briefly recapitulate

[3] CCA Hawtrey Papers 1/13, memorial of Addis and others dated 15 January 1920. F.C.Goodenough, a joint-stock banker and a member of the committee was another signatory.

[4] IOLR L/F/7/607, Commons Question Paper of 28 May 1919; Lucas to Holderness, letter dated 27 May 1919.

[5] IOLR L/F/7/607, Commons Question paper dated 4 June 1919. Note that Cooper's question forged a connection between commodity flows and gold flows.

the relevant changes since the end of the war, in the Indian and the world economic situation. The war over, the US lifted its price controls on silver and as silver prices rose, the rupee had to be effectively raised along with. With the floating of the sterling from March 1919, the rupee rose to about 30d. sterling by December 1919. The removal of the US gold embargo in June 1919, the South African mine-owners' decision to return to London and the resumption of free Australian gold exports in July the same year, enabled some gold to be brought to India.[6] Sovereigns were selling at a premium in India compared to their monetary value, reflecting the general premium obtaining in India over world gold prices as a result of reduced gold imports during the war. The existence of this premium created complications for any attempts at monetary reconstruction and made the perpetuation of gold controls necessary. Therefore the Indian government began fortnightly gold sales from the end of August 1919 and succeeded to some extent in reducing the bazaar premium on gold.[7]

III.1.A THE CONVERTIBILITY ARGUMENT

At first, the chief issue facing the committee was that of ensuring the permanent convertibility of the note issue. As late as July 1919, M.M.S.Gubbay emphasised that a "high exchange" was not recommended with a view to check prices though it would have that effect.[8] Keynes could not easily convince the committee that

[6] Before lifting its gold embargo, the US tried to ensure that there would be no drain of gold to India resulting from her action. The US government wanted to ascertain future Indian policy on gold imports: IOLR L/F/5/36, US Treasury to Blackett, letter dated 22 April 1919. The India Office formally refused to subject India to any "unique disability", but confirmed that public opinion in London would be strongly opposed to gold going to India. The rate offered for gold in India was designed so as not to yield a premium: IOLR L/F/6/1083, F.2942, India Office note accompanying Howard to Blackett, letter dated 14 June 1920 and IOLR L/F/7/612, Qn.97. Unless otherwise stated, all references in this chapter are to the latter file.

[7] Vol.3, Appendix XVIII, pp.100-101; Qn.3989.

[8] Qns.864-870.

inflation was potentially a more serious problem than inconvertibility.[9] Even in October 1919, the Government of India's telegram summarizing the latest changes in the international and Indian economic situation mentioned Indian price increases at the very end of a long list that included the discount on the sterling, the lifting of the US gold embargo, the possibility of fixing a higher gold price and the appreciation of the rupee as a result of increases in the price of silver.[10]

The dominance of the domestic convertibility objective is plain from the arguments that Lucas of the India Office advanced in support of his scheme which was eventually endorsed by the committee. According to Lucas' plan, the rupee was to be fixed at a rate which guaranteed that the silver rupee would remain a token coin. A high rate would enable the Government of India to offer higher prices for silver and ensure that it was available for coinage. Lucas explained that a rupee fixed to gold at 2s. would give India sufficient margin to buy silver over a large range of silver prices.[11] It would enable India to offer up to 138 cents for an ounce of standard silver and tempt the French to melt their silver five franc pieces and replace them with gold. Lucas also firmly established the connection between three issues : India getting enough silver to secure convertibility, the volume of liquidity available to the Western world and the notion that India was entitled to silver while the West was entitled to gold. These considerations recur quite frequently in his evidence and examination. That these issues were upper-most in the minds of the more influential members of the committee is also evident from

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[9] Qns.2724-2725.

[10] Viceroy to Secretary of State, telegram dated 10 October 1919.

[11] A floating sterling necessitated the distinction between a 2s. "gold" rate and a 2s. "sterling" rate. A 2s. "gold" rupee would have equalled 2s. sterling when the sterling returned to its pre-war parity with gold.

their questioning of the witnesses who appeared before them.[12]

Elaborating on the advantages that the silver price margin yielded by a 2s. gold rupee would give the West, Lucas said such a move "would give the Eastern Hemisphere eleven million (ounces) of silver and the Western Hemisphere the same amount (sic!) of gold ... At 138 we could make that offer."[13]

Appearing again a few days later, Lucas said a 2s. gold rupee had several advantages.[14] It corrected prices in India and reduced her demand for the world's gold to the lowest possible level. Besides, it was safer to have too high a rate rather than too low a rate because, with India's enormous sterling reserves "we are much more securely buttressed against a tendency to fall than a tendency to rise". But at 2s. gold, India's trade surplus might fail to cover the Home Charges. If that happened, the rupee would have to be devalued though "our enormous reserves ... would enable us to meet a drain on the scale of 1908-1909 or 1914-1915 for seven or eight consecutive years." Betraying a disregard for the deflationary consequences of a high exchange rate and intervention to defend it, he said "we have such enormous sterling reserves that even if the permanent balance of trade were upset

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[12] In fact, the argument that only a high rupee would ensure convertibility and reduce the Indian demand for gold runs so conspicuously through the official evidence, that it is almost impossible for any reader of these bulky proceedings to miss it. For an instance of this omission, see B.R.Tomlinson, **Political Economy**, 1979, pp.66-70.

[13] Qn.4020.

[14] In this puzzling series of questions, Lucas re-appeared to discuss the rate at which he proposed that the rupee be stabilized. (Qns.4415-22). He said, in his earlier appearances, he had been too pre-occupied with urging the advantages of immediate stabilization to dwell much on the question of the exchange-rate for the rupee. This is a puzzling statement. In answering questions 4002,4003,4012,4020, 4022-36,4053,4078 and 4080, he had argued that his system would be unworkable at less than 2s. gold. He had also explored the effects of lower parities on prices, silver supplies and gold demands. So one is compelled to wonder about why Lucas went back on his earlier views. Qn.4415 suggests that between the two appearances, Lucas had re-considered his ideas on the rupee parity and had begun to harbour doubts about the stability of a 2s. gold rupee.

for many years we could hold the exchange at 2s." The real risk would arise if prices in England fell rapidly. That would prove the case of the exporters and therefore 2s. gold might be too high a permanent rate.[15]

On the other hand, a 20d. gold rate was too low. Besides not being a sufficient check on high prices, the "strongest reason why (it was) dangerously low" was that it allowed a silver purchase price of only 116 cents which created the attendant "risk that India may demand more gold ... than the world (was) willing to part with."[16] He therefore suggested a compromise rate of 22d. gold which, besides being a sufficient check on high prices, would also enable India to get sufficient silver at 126 cents and so "keep her absorption of gold within bounds." He underlined that he was "more impressed with Sir Charles Addis' point than any other - that is, that India should be in a position to meet the objections of the world to parting with its gold - or really what it would amount to is objection of Europe to India getting too much of America's stock of gold, and of new production ...." By offering to take silver she could meet the world's objections, but this could be done only if the "rate of exchange is high enough for them to offer parity valuation or something near it."[17]

Asked by a member if he believed that India was entitled to receive gold against her export surplus, Lucas argued that the only way to deny India gold was through an import duty on the metal. An import duty could be justified by "establishing one plea" : " ... the gold countries would have to convince India ... that the vicious circle between insufficiently backed, over-issued paper money and rising social discontent was imperilling the whole world including India". This was a surprisingly

[15] Qn. 4417

[16] Qns.4418-4419.

[17] Qn. 4421-4422.

frank admission of the political crisis that deflation was feared to cause in a demobilized West which was trying to recover from the war. If he was negotiating for India, he would tell the deficit countries to "keep the gold, and send to India every scrap of silver at a fixed parity ..." and if India still had "any unliquidated gold drain..." he would ask the deficit countries to debase their silver coins and send the silver so saved to India. He added that through such arrangements which involved "neither a bi-metallic nor a silver standard for India", "a great advantage" would be secured for the whole world "by the mere process of placing the two metals where they are most wanted, gold in the west and silver in the east." He went on to emphasize that at 2s. gold, India would get all the silver she wanted and there would be no need for negotiations with the silver holding countries.[18] He stressed that India would have to go on a gold standard only because "silver had become so ... expensive in terms of gold". The only reason for India to take gold would be that she was not getting enough silver.[19] In any case, he re-asserted, a 2s. gold rupee would ensure that the eventuality of India demanding gold would not arise. Responding to an enquiry whether he would not incur "unfavourable criticism in the City" for demanding gold for India, he said, "speaking from the point of one who has to fight the battle for India, I simply come back to my position ... If not gold, then silver at a price."[20]

The members of the committee were not satisfied by Lucas' assurances that a high rupee would enable the bulk of India's liquidity demands to be absorbed by silver. Lucas implied, and the committee accepted in its report, that a standard gold currency in India and a free gold mint would come into effect only if silver could

[18] Qn.4459. The reference to a silver standard was a reference to Lionel Abrahams' proposals for a temporary silver standard which the committee rejected.

[19] Qn.4015.

[20] Qns.4112-4113.

not be bought even at 138 cents a fine ounce.[21] Gold would then meet the needs that silver had formerly met in India. Notes would have to be encashed in gold, with paper notes and nickel coins forming the token money. Addis expressed a fear that it could increase the circulation of gold coin in India. Did Lucas not think that India may "acquire an undue proportion ... of the world's supply of gold" and more than what she was entitled to "as a dependent of the Empire?" Lucas admitted that this was "about the most difficult question to answer ...." The answer depended on how much allowance was made for India's needs and the principle that people were entitled to be paid in the form they chose for their exports. This was outside the currency question and was a political one.[22]

However, he proceeded to reassert his belief that there was only a small probability in his proposals of India needing or getting substantial quantities of gold. He felt confident enough, he said, to remove restrictions on gold imports and implement his scheme even before silver purchases were negotiated. There were "... any number of chances of escape before we come to the desperate alternative of getting no silver". His proposals increased the opportunity of getting silver. Also, India had Rs.500 million in silver in the Paper Currency Reserve. Further, "with exchange weakening, with the war over and things returning to normal, with money coming back in India, the chances that India may never reach the point of making an exorbitant demand for gold seem to be enormously strong."[23] It is interesting that though Lucas anticipated a weakening of the rupee as normal post-war trade resumed, it was not taken into account when the committee revalued the rupee. In fact, in the weeks leading up to the implementation of the new parity, the India Office was to hope that the rupee would stay weak, sales of reverse council bills

[21] Qn.4105-4106 and Majority Report paras. 66-67.

[22] Qns.4106-4110.

[23] Qns. 4114-4115.

would be necessitated and that any residual dangers of India draining gold would be eliminated.[24]

Lucas also undertook that the Indian authorities would prevent the import of gold to the fullest extent possible. "As long as silver can be bought, it will be in the power of the Indian Government to displace imports of gold as a means of remittance by selling drafts against the silver bought. Government will use that check to the full".[25] In this regard, he asserted, there would be no difference between a sterling standard and the system that he proposed. In both cases, council drafts would be sold and "silver purchases ... would ... displace gold imports" in liquidating the balance of trade.[26] In any case, he repeated yet again, a high exchange was a "real safeguard that the gold demand will not be too much." The government was also determined to hold gold only in the central reserves.[27]

The committee's fear of a gold drain to India generated the need to estimate the size of India's trade surplus at various levels of the rupee and the consequent demand she may make on the world's gold resources. It questioned the exchange banking witnesses about the effect of a revaluation on the trade balance. William Meyer, a former Indian finance department official, was also asked a series of questions on the trade balance outcome of a revaluation and one of these questions is particularly revealing. "Would a rise to say, 1s.10d. or 2s. have a material effect on the magnitude of the trade balance that has to be met?" When Meyer replied that it may not have an effect, the committee asked whether "it (was) extremely difficult to measure quantitatively the amount of gold that would be required to act

[24] See PRO T/160/F.260/2, Lucas to Niemeyer, letter dated 27 January 1920.

[25] Qn.4462.

[26] Qn 4496.

[27] Qn.4463.

as a solution to the matter?" Meyer agreed.[28] It is not surprising, then, that the members were not easily satisfied that a 2s. gold rupee would curb the Indian gold demand.

The concern that left to herself, India would drain world gold was central also to the evidence of the Governor of the Bank of England. Governor Cockayne considered that the Imperial Government could legitimately impose restrictions on the quantity of gold available to India. He was worried that, should her controls be removed, India might emerge as one of the highest bidders in the London gold market and that "the whole of the Empire's ... stock of gold might be absorbed by India ...."[29] He stressed that free gold movements to India would reduce the gold that Britain could draw upon to settle her adverse trade balance with foreign nations. India, he said, should not be treated as a foreign nation in this regard.[30] Cockayne also agreed with the Chairman that if India's trade surplus with the United States was settled in gold, the favourable balance available to the Empire to offset Britain's deficit with the United States would be diminished.[31] He also feared that excessive US gold losses to India would increase interest rates just when Britain was hoping for easy monetary conditions in America to ease European deflation. To the extent "America allows her stock of gold to go to India, it will increase her power to draw gold from us or her desire to draw gold from us."[32]

Cockayne opposed lifting controls on private gold flows when there was a domestic

[28] Qns.3173-3174.

[29] Qn.2554.

[30] Qn.2556.

[31] Qn.2544. This consideration, explicitly reflecting what was previously implicit in the pre-war pattern of settlements, continued to figure in discussions on the sterling balances of the overseas sterling area till 1950.

[32] Qn.2544.

premium on the metal in India. But the British disinclination to see much gold going to India was more general. The premium merely worsened the fears of a gold drain. Disputing Cockayne's view that the Imperial interest justified continued checks on gold in India, the India Office, which favoured a relaxation as circumstances permitted, argued that by allowing limited quantities of gold into India, the Imperial interest was not threatened. Brunyate (who represented the India Office on the committee) told the Governor that India needed "some moderate amount of gold" to ensure convertibility and to eliminate the premium which was a "morbid state of things" and a "hampering and inconvenient factor".[33] He tried to persuade the Governor that the demand for gold in India might not be as high as the premium suggested. In the long-run, if India was to be "weaned" from gold, "some substituted food" was necessary. This could only be silver, doubts over procuring which made inconvertibility a real threat. Brunyate asked Cockayne to consider whether, given the importance of India's raw materials and the need to promote the investing and the note-using habits, it might not be "worthwhile" to send some gold to India to see whether the demand could be satisfied by a "moderated amount or whether it is really (a) bottomless demand ...."[34] Thus the concern over the effect of the premium on gold flows to India was not to the exclusion of anxieties about her appetite for gold in the long-run. The India Office position was that in the short-term, India needed gold to remove the premium and restore a somewhat less managed payments system; but India's long-run demand for gold would be kept in check directly by a high exchange rate, and indirectly by the

[33] Qns.2573-2574.

[34] Qns.2577-2578. The Governor was not easily convinced that India's gold requirements would be small. When a total amount of 12 million pounds per year was suggested to him as what might possibly be required, he said "if you were to knock off a "0" it would be more my idea of a small quantity." (Qn.2624); His successor Montagu Norman was also to worry about India. Writing to Benjamin Strong he said India had drained 1.5 million pounds of the metal since the sterling returned to gold. India was, " ... almost irrespective of the exchange ... a great absorber of gold ....", Norman to Strong, letter dated 8 May 1925, quoted in L.V.Chandler, **Benjamin Strong : Central Banker**, Washington DC, 1958, pp.322-323.

substitution possibilities of silver for gold that it opened up. Hence, using gold in limited quantities to "maintain the Indian currency system" was legitimate "from the ultimate Imperial point of view". It was necessary to establish this larger legitimacy because, as the India Office and the Bank of England agreed, the Indian exchange question was not an Indian affair solely, but an Imperial one.[35]

III.1.B THE INFLATION ARGUMENT

In contrast to the dominant role of the convertibility/liquidity factor from the very outset, inflation was almost in the nature of an after-thought. In the early stages of the committee, the Indian government had denied that a revalued rupee was proposed in order to preserve price stability.[36] When he appeared before the committee, Keynes was not to find it easy to persuade members to believe that inflation in India posed a greater threat than the non-availability of silver. In his view, the "currents of trade and indebtedness" took much of the gold to the United States, and hence there was a distributional problem rather than an actual gold shortage. Indeed, Keynes seems to have briefly believed that Indian gold absorption continued to be anti-inflationary for the world as a whole.[37] Therefore, he told the committee, inconvertibility was not the major threat in India. The main danger was potential inflation, while silver availability was the chief "technical difficulty". He sought a high rupee to prevent the former. When Addis persisted in his disagreement, Keynes pointed out, with some annoyance, that his solution for inflation would also resolve the convertibility problem. But Keynes added that

[35] Qns.2568-2569, 2578, 2588-2589.

[36] Qns.864-70.

[37] **JMK**, Vol.1, pp.70-71 and his replies to Qns.2802-2804. Later, under Blackett's influence, Keynes was to change his mind. He warned the India Office against repealing the Gold Import Restriction Act when there was a premium on gold in India since it would lead to suspension of council sales, drain gold from London and weaken the sterling. See **JMK**, Vol.15, p.310 and PRO T160 18/F.571, Keynes to Blackett, letter dated 27 December 1919.

should world prices fall, he would devalue the rupee to preserve price stability.[38]

Not only was the worry over the inflationary regime in the nature of an after-thought, but also, Brunyate's exchanges with Lucas betray a late effort to play down the original justification for a high rupee - to secure silver and avoid the eventuality of a monetary demand for gold by India. Brunyate instead seems to have been at some pains to convey that the more general problem of inflation underlay the plan to revalue the rupee. Brunyate, who was senior to Lucas in the India Office hierarchy, asked the latter if prices did not form the "essential point" and the "foundation" of his scheme.[39] Lucas answered in the affirmative. This could not have been a serious assertion because, when the rupee was successively revalued in the war or when post-war stabilization proposals were being debated within the India office, prices had not been taken into account at all, let alone that they were the "foundation" of the stabilization package. Silver availability survived as the sole factor determining the rupee parity until well after the Babbington-Smith Committee had begun to take evidence.[40]

The next few questions are also revealing. Brunyate suggested to his subordinate that silver would not be available even were the rupee to be revalued in line with its prices and hence, a rupee revaluation could not have been proposed with a view to enable purchase of the metal. But, he continued, the link between inflation in India and the exchange rate was more direct and so, formed the basis for his proposals for a 2s. gold rupee. Thus reacquainted with his own scheme, Lucas

38 Qns.2724-2726.

39 Qns.4052-4053.

40 Apart from Keynes' difficulty in convincing the committee that inflation was a potential problem in India, see Gubbay's testimony to the committee with its almost exclusive focus on convertibility problems and the initial emphasis of Lucas' evidence.

accepted his senior's interpretation and fell in line.

Brunyate's "questions" (in reality, they were statements) merely served to place it on the record that inflation and not convertibility was the only, if somewhat belated, concern of the India Office; we derive no insights whatsoever from Lucas' replies. The strong flavour in these exchanges is that of an experienced bureaucrat nudging an erring junior to say the right things![41] But soon, Lucas was to contradict himself. Having been goaded to say that a high rupee was not an absolute "safeguard against inconvertibility ..." because it was no guarantee of silver availability, he was to say before the ink was dry on this statement that, at a 2s. gold rupee, India could get all the silver she wanted without even having to negotiate for it.[42]

So, why was Brunyate so keen to supplant the silver price explanation for a high rupee with the inflation explanation? In answer, we have to consider the possibility that if revaluation continued to be justified by the need to preserve convertibility, it could draw exaggerated attention to the imperial priorities which dominated Indian currency policy in the war. There was a limit to the extent to which the rupee could be revalued (and the Indian economy deflated) merely in order to preserve the token character of the silver rupee and prevent the circulation of gold, without evoking excessive opposition in India. It might have been felt that 2s. gold, this limit would be crossed, and that the continued use of the silver price argument would only reinforce the Indian demand for a gold standard which was not hostage to silver. Consider in this context the evidence of Manusubedar and V.Thackeray to the committee and in particular, their indictment of India Office policy. Since Indian currency policies in the war, as became evident later, created

[41] Qns.4052-4053.

[42] Qns.4056 and 4459.

more serious problems than they resolved, the technical mystique which the India Office gave to financial policy would have become harder to sustain. Financial policies would have been drawn into the arena of political conflict, endangering the freedom that India Office sought for itself to frame policy.

On the other hand, if the India Office could use inflation as a pretext to push through policies that would have been adopted anyway, they could make a virtue out of necessity and quote the general interest against the anxieties of more educated opinion. As much is implied in an India Office memorandum on the Imperial Currency system. It admitted that it was "impossible to exaggerate" the "political side" of the monetary policy debate. Currency policy in India had "been justified as a policy deliberately conceived in India's exclusive interest. If the Indian were in a position to ascribe ... the high cost of living .. to the subordination of his currency system to the vagaries of the sterling, the British case for controlling Indian currency policy would have received a blow which would react on the whole of British administration in India".[43] The implication was that there were limits to the extent of the rupee's subjugation to the sterling. As inflation in India could be attributed - as the Indian witnesses to the 1919 currency committee did - to the denial of gold to India during the war, active measures to check it would establish in the popular perception that London's hands were clean of any culpability in the matter. On the other hand, subjects such as gold in currency reserves were the subject of restricted comment and so, if a diversion of gold to India could be avoided by using an argument that seemed on the face of it much more general, that would nicely handle the "political side" of the monetary question.

Also, an activist exchange-rate policy represented a major departure from accepted

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43 PRO T160/550 F.7219/1, "The Position of India in Regard to an Imperial Currency System", India Office memorandum dated 26 April 1920.

economic theory and practice. Given the conservatism of policy-makers in Britain, it would have needed much more than the mere threat of inflation on the periphery to justify the departure.

The Indian government was an innocent spectator of this unfolding strategy. Its fear of the political consequences of inflation and its ignorance in this period of the effects of policy instruments on non-target variables strengthened the argument for a revaluation.

The India Office concern for price stability and its inclination to use the exchange rate to preserve it were never consistent. While the exchange rate was used to deflate the Indian economy in February 1920, the fall in world prices after June 1920 did not cause it to abandon a parity chosen ostensibly as a price stabilization device, although the currency committee had recommended such a course. Even an Indian government proposal that reverse council bills should be sold by tender rather than at the 2s. gold rate, was initially unacceptable to London.[44] As late as September 1921, the 2s. gold rupee remained the "declared objective of policy".[45] Absurdly, even in August 1922, the India Office thought that the Government of India should not give up the 2s. gold objective.[46]

The burden of the argument that India Office policy on the use of the exchange rate to preserve price stability was inconsistent over time lies mainly in the 1920s and the 1930s and these periods do not come within the scope of this chapter. In

44 IOLR Mss.Eur.D523/4, Montagu to Chelmsford letter dated 8 April 1920 and 13 May 1920. Also see IOLR L/F/6/1083, F.2942, Secretary of State to Viceroy, telegram dated 12 June 1920.

45 IOLR L/F/6/1088, F.2149, Secretary of State to Viceroy, telegram dated 16 September 1921. By then Indian prices had fallen some 25% over January 1920.

46 IOLR L/F/6/1088, F.2149, memorandum by F.C.Goodenough dated 14 August 1922.

the pre-war period too, the India Office had not shown any great determination to use revaluation to check price increases in India. Over 1904-1908 for example, prices in India rose more than it did during the war and much faster than it did in the United Kingdom.[47] A Government of India proposal to enquire into the phenomenon was rejected by the India Office on the ground that inflation in India was due to world factors rather than any factors peculiar to India.[48] The anti-inflation argument for a 2s. gold rupee in 1919-1920 was flawed for the same reason.

Consider the available price indices for India and the United Kingdom in Table **III.1** below. Consider first column one. Retail food grain prices fell over 1914-1917 and increased in 1918 because of a disastrous harvest, when output fell by nearly a quarter. Consider next, the import price index. Not surprisingly, of all the Indian price indices, this increased the fastest, and by more than domestic prices in the United Kingdom. With India's export prices rising by less, the terms of trade moved adversely for India. Also, if column three is regarded as reflecting better than the other indices, the price movements in the Indian import replacing sector, then clearly, contrary to received beliefs, prices of import substitutes rose more slowly than import prices. In fact, almost the entire increase in prices over 1914-1917 can be attributed to imported inflation. This was recognized by the Department of Statistics of the Government of India. However the Indian government failed to draw the correct conclusions about the ineffectiveness of small country deflation in an inflationary environment.[49]

[47] Appendix III in Memorandum B by Lionel Abrahams, Vol.2, p.89.

[48] S.Ambirajan, **Political Economy**, 1984,pp.166-167.

[49] Appendix XXVIII, Vol.3, paras.9-11, p.162. There was a spurt in inflation in India over 1918-1919, but much of this, apart from a delayed effect of a monsoon failure the previous year, seems to have been a lagged response to world inflationary pressures. Despite this, Indian price levels and the rate of price increases were well below those in Britain and the USA.

TABLE III.1 : INDIAN AND BRITISH PRICES, 1913/14-1917/18

YEAR	INDIAN INDICES				UK RETAIL INDEX
	1	2	3	4	
1913/1914	222	114	160	147	77
1914/1915	218	146	155	152	97
1915/1916	201	236	163	184	123
1916/1917	202	262	170	196	158
1917/1918	270	289	199	225	174

All 1873=100;
1. Special Retail Food-Grain Price Index.
2. Special Index of Import Prices.
3. Special Index of exports and Consumables' Prices.
4. General Index.

Source: IOLR L/F/7/612, Appendix III in Memorandum B by L.Abrahams, Vol.2, p.89.

The literature on the sharing of adjustment burdens in the gold exchange standard is comparatively recent. There can however be little doubt that modern theories in this area only systematized rules that existed in a rough and general way in the pre-war gold standard. Although there are differences on the degree of discretion attending monetary policy in a system that was supposed to be automatic, there is little difference on the notion that the robustness of the system depended on the key-currency centre avoiding inflation which, in the absence of reserve discipline, could threaten systemic stability. The secondary reserve holders could, on their own, not do much to mitigate global inflation or insulate themselves from it. They could best contribute to world stability by avoiding excessive reserve accumulation. At any rate a distribution of adjustment responsibilities on the above lines represented no departure from contemporary theory and experience, while the use of the exchange rate to fight inflation was, as we have mentioned earlier, a relatively new and unusual step. The inability of a small country to resist inflation when the rest of the world was inflating or expected to inflate was, as we examine in the next chapter, once again accepted by the India Office less than three years later.

But we have the Babbington-Smith Committee showing ostentatious concern over Indian inflation as well as worry about her capacity to draw gold. Lindert argues that secondary reserve accumulation by India which would "never lose faith in the sterling" because of the colonial connection was preferable from the British point of view to that by countries that had greater freedom of portfolio choice.[50] This was no doubt true. But in the Indian case, private gold holdings were more important than official holdings because of their size and because they were supposed to inhibit the monetary and real adjustments that gold flows were expected to cause. Therefore, British monetary authorities - having already ensured that official Indian

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[50] P.H.Lindert, **Key Currencies**, 1969, p.16 and p.38 f.n..

sterling reserves would not be converted into gold - had to attend to the question of private Indian reserves and ensure that private gold demands and existing holdings of the metal could be similarly influenced. The discussions on convertibility and inflation conveyed this concern in a short-hand form. Guaranteed convertibility would affect private portfolio choice and make non-gold asset holdings more likely and perhaps in time, shift the composition of pre-existing asset portfolios. A deflationary policy on the other hand would switch the demand of the Indian consumer away from metals and towards commodity imports in the short-term (useful especially if political and social resistance to deflation retarded price adjustments at the centre). Further, to the extent that it affected incomes in India, it could be expected to affect private reserve appetites and in the extreme case, lead to reserve liquidation.

As much was envisaged in the deliberations of the currency committee. The link between prices and incomes was well recognized and recurred throughout the discussions. There was also much speculation on the link between prices and private asset demands. Gubbay conceded that high prices accentuated the tendency to regard precious metals as a store of value. He agreed with Addis that a fall in prices would lead to "such a lightening of the burden as would throw a number of rupees back into circulation". Lower prices, it was suggested in the committee, would lead to a lower currency requirement and lead to a return of silver rupees whether from an increased "purchase of imports" (the asset substitution effect) or from a process identical to what would happen "under necessity, such as a famine" or a "bad monsoon" (the income effect). Thus, regardless of whether the prices affected were those of imports or of exports, a fall in prices would reduce the Indian demand for precious metals.[51] In a revaluation, both effects would operate

[51] Qns.340-347. No distinction is drawn here between financial assets and physical assets and it implies that they were close substitutes in the portfolios of the Indian income-earner. This at any rate was an assumption that existed in India Office policy and is evident in some of their speculations on the reasons behind

and to that extent, India would relieve her pressure on the world's gold stocks and mitigate the threat of deflation in the West. If reserve liquidation by India also took place in consequence, that would further augment world liquidity. Briefly then, if there are limits to private demands for key-currency assets or there is a disinclination to meet that demand because of unregulated conversion possibilities, deflation has the same consequences for world liquidity with respect to private gold reserves as inflation has with respect to official reserves.

There is no other hypothesis which is capable of explaining the bizarre distribution of adjustment responsibilities that Britain sought in 1919-1920 and the nature of adjustment she expected from her creditors. In a political environment where Britain's prescribed role of leading the world economy in deflation had become a source of domestic political conflict, she was driven to seeking other means of preventing the disintegration of the system she was, somewhat feebly, presiding over. It is necessary to place immediate post-war Indian financial policy in a wider context.

At the end of the war, the United States curtailed and soon eliminated official lending to its European allies and insisted on prompt re-payment of their war-debts. She further hampered Europe's capacity to earn dollars by sharply raising her tariffs.[52] Europe was already facing severe social and political problems caused by the war. Reconstruction became an urgent necessity and Europe turned to deficit spending to finance it. The policy choices flew in the face of official orthodoxy,

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India's large gold demand in the 1920s. Chapters Four and Five examine some evidence of this assumption. When there is a non-income yielding financial asset like gold, which could also perform some functions as a physical asset, the distinction between the two kinds of assets might be blurred. See A.G.Chandavarkar, "The Nature and Effect of Gold Hoarding in Under-Developed Economies", in P.C.Malhotra and A.C.Minocha, eds., **Studies in Capital Formation, Savings and Investment in a Developing Economy**, Bombay, 1971, pp.78-80.

[52] B.Eichengreen, "International Policy Coordination", in Buiter, W. and Marston, R., eds., **The International Coordination**, 1985, p.147.

but were made for political rather than theoretical reasons. The fear of revolutionary politics in Britain led to expansionist fiscal policies in 1919 which weakened the sterling and worsened her inflation problem.[53] These policies lasted till April 1920.

During this period (and afterwards) Britain hoped to force the United States to sustain her expansionist policies. Fearful of US action as the Federal Reserve's gold levels approached the legal minimum, Blackett at the British Treasury advocated gold exports to the United States in repayment of war debts so that it might "cause an appreciable rise in American prices and ... bring them up nearer the level of our own."[54] He pleaded with Governor Strong of the New York Federal Reserve to inflate the US economy because, otherwise, Britain would need a "big drop in prices" which she could not "face socially or politically ...."[55]

Blackett was not alone in desiring an US inflation. Hawtrey, also in the Treasury, did not want England to deflate to any significant extent in November 1919 because the resulting gold imports from the United States would be a brake on expansion there.[56] Hawtrey's argument was convenient to the Treasury in the context of the differences amongst British politicians and financiers on domestic interest rate policy which was to remain a contentious political question over the next twelve

53 A.Glynn and S.Booth, "Unemployment in Inter-War Britain", **EHR**, 1983, pp.338-341. These factors figured explicitly in the Indian currency committee; see Lucas' answer to Qn.4459.

54 PRO T172/1384, "Dear Money", memorandum by Blackett dated 21 February 1920, Appendix, p.24.

55 Blackett to Strong letter dated 23 December 1919 quoted in Chandler, **Benjamin Strong**, 1958, pp.297-299 and Clay, **Lord Norman**, 1957, pp.115-118.

56 CCA, Hawtrey Papers, 1/13, "Financial and Economic Effects of a Levy on War Profits", memorandum by Hawtrey dated November 1919. When Hawtrey was rejecting deflation in Britain on external grounds, Britain had inflated more than India in the war.

years.[57] When Britain was seeking continued US expansion and resisting domestic deflation, prices in the United States and Britain had risen more, since the war, than they had in India, though US prices had increased by less than those in Britain. This seeming paradox, of the country with the highest rates of war-time inflation among the three countries considered, resisting deflation while recommending disparate policies to two countries similarly placed with respect to herself, reinforces a point that was made above. Lower interest rates in the USA and a higher rate of inflation would have enabled relatively trouble-free recovery in Britain and a smooth return to gold of the pound sterling. US expansion would also lead to US gold losses, though the size of the latter needed to be regulated. But US gold exports, by enabling Britain to repay her debts to America more easily, would also ensure that US expansion did not grind to a halt because of primary reserve drains. By attracting more borrowers and thereby relieving the burden on London, easy money in the United States would also in the long-run achieve a distribution of world monetary gold more in line with British interests and mitigate the domestic deflation necessary to restore sterling to its pre-war parity.

In other words the intended effect of a hefty revaluation of the rupee, viz., avert Indian private sector gold drains and secondly perhaps, cause it to dis-hoard, was the thread that linked the seemingly disparate policies that Britain wished India and the USA to adopt in almost identical circumstances. They could together keep London liquid and reduce loss of output and employment in the course of the sterling's return to the gold standard and London's return to the leadership of the global financial system. The difference was, Britain could ensure that India played

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[57] A.Boyle, **Montagu Norman**, 1968, pp.131-132; H.Clay, **Lord Norman**, 1957, pp.115-118; Chandler, **Benjamin Strong**, 1958, pp.297-299 and p.149; Hume, P.J., "The Gold Standard and Deflation : Issues and Methods in the 1920s" in S.S.Pollard ed., **Gold Standard**, 1970, pp.122-145. Also see PRO T172/1384, "**Memorandum as to Money Rates**", by the Bank of England dated 10 February 1920 and Cockayne to the Chancellor, letter dated 25 February 1928. There was also a Cabinet split over the Bank rate. See SOAS Addis Papers Pp.Ms.14/271, letter to his wife dated 8 February 1920.

this costly role, but she had no means of securing the American cooperation so necessary for enacting her scenario.

There are two more problems in the inflation argument to revalue the rupee. Firstly, given the size of the Indian traded goods sector, it is doubtful whether the exchange rate could be correctly regarded as a general anti-inflationary instrument. Secondly, world conditions did not conduce to its effectiveness in the context in which the currency committee recommended its use. And here there is a contradiction in its argument. The majority report argued that a 2s. gold rupee would not affect Indian exports because some Indian exports were "virtual monopolies with assured markets" and in the case of the others, the "world demand (was) insistent despite the high range of prices."[58] If that indeed was the case, it is hard to see how the exchange-rate could be used to reduce prices, especially if Britain was resisting deflation and was trying to get the USA to inflate. If world demand did not react to an increase in the prices of Indian exports either because of the nature of the latter or because their dollar or sterling prices had, even after a rupee revaluation, risen less than world prices, then the exchange-rate would not affect domestic prices in the desired direction to a significant extent. But as we see later, the actual India Office expectations about the conditions of the markets for Indian exports and the stability of a 2s. gold rupee were different from the picture that its officials painted before the committee.

In contrast to the official reserves of gold standard countries or Indian private reserves, Indian official reserves offered fewer possibilities. Most of these reserves were already in sterling securities or silver (which in this period is best regarded as an addition to world liquidity with limited switching possibilities because of asset market conditions). The committee therefore proceeded to ensure that the new

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[58] Para.51 of the Majority **Report**.

Indian reserve policy would leave the war-time sterling investments in the Paper Currency Reserve undisturbed.[59]

However, the committee was not satisfied with merely preserving the status-quo on reserve composition and preventing gold drains to India that may arise from changes in reserve policy. We have already examined its aggressive aims in regard to private reserves. The one way in which Indian reserves could keep London more liquid than it already was doing would be if rupee holders could be induced, by riskless offers, to switch to long-term sterling paper or to make other long-term investments in London. Were that to happen, short-term sterling assets of the Government of India (the periphery) could turn up as similar or longer claims (on the government or the banking sector) in private portfolios at the centre. The 2s. gold rupee offered attractive terms for such transfers, while low interest rates in India even as unprecedented reverse sales were taking place from January to October 1920 may have ensured that war-time profits in India had a further inducement to move to London.

We have shown earlier that a 2s. gold rupee was clearly intended to affect private reserve appetites and influence their composition. To the extent that they would not be liquidated to finance a gold drain to India, the new rupee parity would also ensure that the composition of official Indian reserves and their size remained unaffected. Given the small size of this stock (the bulk of which was in sterling anyway) in relation to the annual private gold flows to India that were feared to occur, it is not surprising that the size and composition of Indian official reserves

[59] Majority **Report** paras 75-80. As against the fiduciary maximum of Rs.200 million suggested by the Chamberlain Commission and the Rs.1200 million in force during the war, the Babbington-Smith Committee suggested a statutory minimum of 40% metal in the Paper Currency Reserve. As is evident in the table that it used to clarify its reserve composition formula, at the November 1919 note circulation level of Rs.1796.7 million, the new proposals required no increase in the metallic component of the reserve. Besides, unlike previous committees, this one did not specify a minimum gold holding in the reserve.

were not discussed at any length in the committee. But an adverse effect on official reserves of such a substantial revaluation would not have been wholly unexpected. Indeed we can show that the India Office expected and hoped, for reasons not unconnected with the multilateral scenario involving Britain that we have sketched above, that the new exchange rate would reduce the size of India's sterling balances. The difference between Indian reserves being run down to import gold and their being used to defend an overvalued parity lay in the impact that each had on London's liquidity position.

It was clear even in early 1919 that rupee-holders were holding out for higher silver prices and re-investing to take advantage of the increased profitability of investment in India.[60] Kisch told the Hilton-Young Commission a few years later that the prolonged efforts to maintain the 2s. rate "helped people ... to get out of ... commitments ...."[61] During his testimony to the Babbington-Smith Committee, Lionel Abrahams had said it was desirable, though it was normally the outcome of a "misfortune", that the Paper Currency Reserve be sent to India through reverse sales.[62]

Lucas also expressed a similar hope. We have referred already to his forecast of a weaker rupee.[63] In correspondence with the Treasury soon after the committee's report was prepared, he hoped for extensive sales of reverse council bills to dissolve Treasury fears that the transfer of the Paper Currency Reserve to India would involve large metallic remittances. The issue that gave rise to Lucas expressing hopes about reverse sales in India is in itself instructive, and may be

60 Government of India, **Report of the Controller of Currency, 1917-1918**, para. 11.

61 IOLR V/26/302/8, Qn.11085. Kisch was justifying the 2s. rate.

62 Qns.1035-36.

63 Qn.4114.

reviewed briefly.

In November-December 1919, the US Treasury sought a payment of $125 million from the British Treasury for Pitman Silver in the form of rupee credits at the 16d.rate. The India Office and the Treasury predictably refused to offer the rupee at any thing less than the market rates.[64] The Treasury wanted to finalize arrangements with the India Office on the supply of rupee credits to the USA in advance of any possible settlement with the latter government. After the India Office agreed to sell council bills in New York, the Treasury asked it not to remit the resulting sterling receipts to India in the form of precious metal and to spend them in England.[65] In reply, Lucas doubted that the USA would require large credits "especially if we are in for a period of weaker exchange (as we rather hope) in consequence of the very high rate which is about to come into force".[66] Further, his department could not spend more than the budgeted amount on the railways and though he was willing to discharge India Office sterling obligations with the anticipated American receipts, these latter would be considerably larger than the former. Besides, the India Office was expecting to receive 55 million pounds from the War Office, while its projected sterling expenditure was 40 million pounds. If the balance was not remitted to India, the whole of the Indian resources would be in London and the Government of India would be "cleaned out". He would prefer remitting silver to sending gold, but silver exports were just as bad from the

[64] PRO T160 F.260/2, India Office to Treasury, letter dated 11 December 1919. The American demand was the beginning of a bargaining process at the end of which they might have hoped to take advantage of Britain's dollar shortage problem to secure cheaper rupee credits. To the extent the British dollar liabilities could be settled in rupee credits, the pressure on her gold and dollar reserves would be reduced. In the event the bargain was not struck because of the collapse of the market for Indian exports. As papers in the above file show, the British Treasury remained interested in the deal and wanted a reluctant India Office to sell councils in New York.

[65] PRO T160 F.260/2, Niemeyer to Lucas, letter dated 24 January 1920.

[66] PRO T160 F.260/2, Lucas to Niemeyer, letter dated 27 January 1920.

Treasury's view point (since the silver had to be bought in the United States). "The best that can be hoped for from your point of view, - and indeed also from ours, since we wish to do everything we can to get out of our own difficulties without increasing yours, - would be if there were in the course of next year, a very strong demand for homeward remittances resulting in a net excess of reverse drafts over Council drafts".[67]

The bureaucratic shorthand of "sending" reserves concealed the fact that different methods of transferring reserves would have had different results in India. Normally, metallic remittances to India would strengthen the reserve in India and forestall inconvertibility. This should have been the preferred alternative to "sending" the Paper Currency Reserve to India through reverse sales. But we have already seen London's problems with regard to Indian gold demands. Silver was a problem because, much of the silver would have had to be imported from the USA and in large quantities, it would have imposed a strain on Britain's dollar reserves and on the sterling. With the steep fall in the sterling, this was, perhaps temporarily for the Treasury, a bigger problem than Indian gold demands. In this situation, as reverse council bills were sold, notes and silver rupees circulating in India would return to the Currency Department. The sterling portion of the currency reserve in London would decline and the metallic portion of the reserve in India would be strengthened at a lower level of note and coin circulation. Sales of reverse councils which involved the liquidation of Treasury bills in London created inconveniences for the Treasury.[68] But this was the only means of resolving the threat to domestic convertibility in India without worsening Britain's liquidity crisis. What this means in portfolio terms is that as the sterling paper in official Indian reserves are liquidated, in India, monetary resources are withdrawn and cancelled

[67] PRO T160 F.260/2, letter dated 27 January 1920.

[68] CCA Hawtrey Papers, Htry 1/21. Blackett to Falk, letter dated 28 September 1920.

and silver moves from private Indian reserves to official reserves. The convertibility crisis is thus resolved both by the reduction in note circulation as well as the increased return of silver rupees to the currency authorities. In more general terms, the Indian economy is deflated to avoid reserve drains in the West and that to an extent, the metallic resources in private Indian reserves make up for the British reluctance to ship any metal - even silver - to India. Therefore when Meyer warned the 1919 currency committee of an "insidious" Treasury which may resist the demand for gold by India or when some Indians thought that Indian reserves were recklessly sold to prevent India from converting them into gold, they were not far off the mark![69]

III.2 THE TREASURY RESPONSE TO THE REPORT

As we have seen, the Babbington-Smith Committee was not easily convinced that even at 2s. gold, India would not set up an unmanageable drain on the world's gold reserves. The Treasury was even harder to convince though its anxieties derived from other reasons. It thought that if controls on gold movements were lifted at the same time as the 2s. gold rupee was adopted, the nominally cheaper gold would lead to large gold flows to India.

It was only late in October 1919 that the Treasury intervened officially in the formulation of post-war currency policy in India. In a letter to the Prime Minister, Gershorn Stewart M.P. said that if India took all the gold she wanted, Britain's return to gold could be indefinitely postponed. He therefore suggested that the Babbington-Smith Committee's report should not be published till it was approved by

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[69] Qn.3319; NMMA, Purushottamdas Thakurdas Papers, File 58, Madon to Thakurdas letter dated 26 March 1926. The reasons for heavy post-war investment in infra-structure needs also to be examined perhaps from the same angle.

the British government.[70] On being forwarded the letter, Blackett noted that Stewart was right in regarding the report as a matter in which "the British Empire and indeed the world has a big interest". If it came to the Treasury as signed, there was no "possibility of either withholding it or altering it." He therefore proposed to write to Babbington-Smith to let the Treasury see the draft report at an early stage so that it could make observations "from the general standpoint of the British Treasury's interests."[71] Accordingly, Babbington-Smith sent him the first draft of the report before it was discussed in the committee.[72]

Hawtrey who was the first Treasury official to read the draft report did not mince words. He said its recommendations would increase the commodity value of gold and this was "disastrous, ..., at least to Europe ...." At the cost of a depression and a grave crisis, the pound could possibly be raised to its old value of 113 grains. But "if the value of 113 grains of gold is to be raised to its old level in terms of commodities ..., the restoration of the pound sterling would be a sheer impossibility".[73] Blackett agreed. Though the report may be justified from the Indian view point, "the Chancellor ... would be entitled to claim ... an overwhelming voice in a matter where the ... interests of India clash in some degree with those of the British Empire or the world." Action such as that proposed in the report "might just make the difference between an early restoration of the gold standard here and permanent inconvertibility."[74] Blackett's frank analysis of the report highlights the contemporary British concern about gold going to India and her

[70] PRO T176/3, Gershorn Stewart to Bonar Law, letter dated 22 October 1919 and a note by him dated January 1918 on silver.

[71] PRO T176/3, Blackett's minute dated 28 October 1919.

[72] PRO T176/3, Blackett to Babbington-Smith letter dated 30 October 1919; PRO T160 18/F.571, Babbington-Smith to Blackett, letter dated 11 December 1919.

[73] PRO T160 18/F.571, note by Hawtrey dated 17 December 1919, "Indian Exchange and Currency Committee : Draft Report".

[74] PRO T160 18/F.571, note to Chancellor dated 18 December 1919.

desire to return to gold without much deflation.[75]

Acknowledging that there were strong reasons to peg the rupee to gold, Blackett regretted that the rupee had no fixed link with the sterling. The Treasury could raise no objections to this nor to the 2s. gold rate, "**provided** ... this recommendation is not regarded as necessarily resulting in the acceptance of all the ... recommendations ... regarding the free import of gold into India and its use there as currency. ... if carried into effect, (they) would have such serious consequences on the currency systems of the United Kingdom, the British Empire, and indeed of the whole world ... that the British Treasury are bound to take the strongest objection to them." He said the prospect of adoption by India of a policy that would raise the value of gold would cause alarm everywhere. The war had greatly lowered the purchasing power of gold which should remain low because, during the war huge national debts had been created, parts of which, such as debts to the United States, had to be paid in gold. "The one element of hope in the present confusion is that owing to the diminished purchasing power of gold the distance to be travelled from a paper to a gold standard has ... correspondingly lessened. The policy of the British Government ... is to try and get back to the gold standard as soon as ... possible without a violent break in prices the social consequences of which were disastrous. So long as the purchasing power of gold is only about 9s. in the sterling as compared with pre-war prices ..., the ideal of a restoration of the gold standard in this country is reasonably within reach. If India is allowed to set up an effective demand for gold ..., all hope of restoring sterling to parity must be abandoned." He suggested that India should not adopt a free gold import policy "for an indefinite period" as the new rate could be implemented without it.

Blackett's reacted with fury to the argument that India could liquidate her surpluses

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[75] PRO T160 18/F.571, "Indian Exchange and Currency Committee", Blackett's undated note; all emphasis in the original.

in any manner that she chose. If India pressed its claims "... the rest of the world would be bound in self-defence ... to take steps to restrict their purchases from India. British rule in India and the consequent internal prosperity have built up Indian commerce, till India has become a creditor country on an important scale. In the world as it is at present organized, a creditor country ... becomes a menace to the world unless it adopts the recognized method of foregoing present enjoyment of a part of its income for the sake of investing it in new capital developments at home and abroad. If India demands payment in precious metals to an extent that is unreasonable, the British Government will be doing a doubtful service to the world in protecting India against the marauding invaders whose raids in olden times served the purpose of relieving her of superficial hoards of gold."

In his letter to Babbington-Smith opposing the report, Blackett pulled rank. "Anything ... which tends to increase the purchasing power of gold at the present time works in opposition to the British Government's policy of restoring the gold standard at an early date", and the Chancellor would object to these proposals when they came up in the Cabinet, he warned.[76]

But the letter came two days after the committee met and approved the majority report without any changes. Blackett feared that even the issue of the report could increase the price of gold and bring pressure from India to all implement its recommendations. He therefore asked the Chancellor to ask the Secretary of State for India, to hold up the report.[77]

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76 PRO T160 18/F.571, Blackett to Babbington-Smith, letter dated 22 December 1919.

77 PRO T160 18/F.571, note by Blackett dated 29 December 1919. Blackett also tried to mobilize other opinion. He made a week-end trip to Cambridge to discuss the report with Keynes who agreed that controls should remain in force in India. Otherwise, the bazaar premium on gold would draw so much gold into India as to be a "severe burden on the sterling exchange." Keynes to Blackett, letter dated 27 December 1919. Following Blackett's visit, Keynes also wrote to Lucas along the above lines. See **JMK**, Vol.15, pp.310-11.

The Chancellor of the Exchequer, Austen Chamberlain sent Montagu a copy of the "most important note by Blackett" and suggested a joint India Office - Treasury conference to discuss the report. In the meanwhile he suggested postponing its publication.[78] In reply, the Secretary of State enclosed a draft telegram to the Viceroy which referred to Blackett's "weighty and reasoned memorandum" and recounted Treasury reservations "which had already struck my advisers independently as requiring anxious consideration ...." It suggested retaining controls on gold exports and selling increased quantities of bullion in the market to bring down the domestic premium.[79]

The joint Treasury - India Office conference duly took place. A India Office telegram to the Government of India which followed said that the controversial report could not be implemented in "entirety" till world conditions became normal. At the Treasury's insistence, the telegram said that the immediate step (fixation of a 2s. gold rate) should be distinguished in any announcement, from other future steps.[80]

The Treasury was keen to prevent the view gaining ground that the lifting of gold import restrictions in India was imminent. It wanted the statement which announced action on the committee's recommendations to clarify that the transitional period towards freer gold imports could be "very considerable". It rejected an India Office draft which said gold import restrictions were "intolerable". In the end, it was replaced by the weaker statement that the controls could not be

[78] PRO T160 18/F.571, Chancellor to Montagu, letter dated 2 January 1920.

[79] PRO T160 18/F.571, Montagu to Chamberlain, letter dated 5 January 1920 and the enclosed draft telegram.

[80] PRO T160 18/F.571, Blackett to Lucas letter dated 9 January 1920.

"contemplated" as a permanent arrangement.[81] In the end the announcement was made along the lines desired by the Treasury. Only the committee's majority recommendation of a 2s. gold rupee was implemented, with results which we examine in the next section.

III.3 THE RESULTS

As is well known, the move to stabilize the rupee at 2s. gold met with disastrous results. As early as January 1920, the flow of remittances had changed direction. With a fall in the sterling-dollar parity, the 2s. gold rupee yielded a rupee-sterling parity of about 33d. on 5 February 1920 and about 35d. on 12 February 1920. After this, the rupee fell as the sterling appreciated. By June 1920 the balance of trade had turned adverse and the rupee had fallen below 2s. sterling. The deterioration on the trade account as between 1919/1920 and 1920/1921 was of the order of about Rs.2000 million.[82]

The high rate provided a stimulus to transfers out of India especially as the reverse rates were always kept on a higher level than the rate for bank remittances.[83] As such, the demand for reverses greatly exceeded the sterling offered for sale by the Government of India for most of the period till the end of September 1920. Reverse sales totalled 55.4 million pounds over January - September 1920. At the end of this period the rupee was on 21d. sterling corresponding to 15d. gold.[84]

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[81] PRO T160 18/F.571, Blackett to Lucas, letter dated 10 January 1920.

[82] IOLR V/26/302/7, Appendix II to Appendix B, McWatters' memorandum, Vol.II, p.25.

[83] Government of India, **Report of the Controller of Currency**, 1920/1921, para.16. For a detailed account of the efforts to make the rate work, see IOLR V/26/302/7, Appendix 3, McWatters' memorandum, Vol.II, pp.15-17.

[84] IOLR L/F/6/1084, F.6186, "Exchange and Currency Position", note by Kisch dated 5 October 1920.

From March 1920, reverse sales led to the liquidation of the sterling securities in the Paper Currency Reserve. However, between February and September 1920, note circulation fell by less than the sale of sterling. Even so, gross note and coin circulation fell from Rs.1850 million to Rs.1580 million between February and September 1920. The excess issue in relation to sterling reserves (Rs.280 million) was backed by the issue of rupee securities to the reserve. Money in India in the circumstances was surprisingly easy.[85]

By April 1920, the Government of India was beginning to question the wisdom of selling sterling at the official gold parity when the rupee was so weak in the market, a situation which even the India Office would find indefensible two months later.[86] Delhi proposed selling limited amounts of reverse council bills by tender. The India Office promptly rejected the idea.[87] In an accompanying memorandum, the Indian government was told that it could not hope to implement the new ratio without a struggle. Counselling perseverance, the memorandum claimed that sterling demands had fallen and the divergence between the official rate and the market rate had diminished. Demand for councils was about to set in, the India Office assured sceptical officials in Delhi, and even if that did not transpire, it was best to continue to assume that the system would stabilize in the next busy season. The memorandum then went on to exhort. No alternative proposals had been suggested, it said. The Indian government should show more spirit and consistency as the situation created by the war could not be "smoothly corrected". Somewhat absurdly in the light of its aims and results, the memorandum claimed that the chosen policy

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[85] Government of India, **Report of the Controller of Currency**, 1919/1920, Para.22 for the period till March 1920 and the **Report** for 1920/1921 for the later period. Also see IOLR V/26/302/8, Kisch to Hilton-Young Commission, Qn.11093.

[86] IOLR L/F/6/1083, F.2942, "Removal of Control over Imports of Gold into India", undated Finance Department note, June 1920.

[87] IOLR Eur.Mss.D523/4, Montagu to Chelmsford, letter dated 15 April 1920.

had "exclusive regard to Indian interests, indeed with almost amazing disregard of other interests which have a strong claim on India's consideration ...." It did not specify what the neglected "interests" were. The policy protected India from an "infinite enhancement of prices ... no less a question than this ... is bound up in the question whether the Government of India shall or shall not continue to sell reverses at a fixed rate." In the end however the force of events compelled the India Office to modify its rupee sales policy from June 1920.

One effect of the prolonged and unsuccessful efforts to stabilize the rupee at an overvalued parity was that it created the possibility of lifting controls on gold imports into India. As recently as April 1920 London had believed that the premium on gold in India still ruled out such a course.[88] But the confident expectation only a month later was that India could no longer absorb gold to the extent previously feared.

Urged by the Indian government, the India Office took up the matter with the Treasury again in May. It pointed out that there was no reason to fear a gold drain because the fall in the rupee had eliminated the premium on gold in India.[89] The India Office prepared a memorandum outlining why the embargo should be lifted.

The memorandum advanced several reasons.[90] It argued that a policy of limited reverse sales could only be justified if free movement of gold prevailed. If reverses were sold, as was now being contemplated, at 2s. sterling, imports of gold into India

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[88] IOLR L/F/6/1083, F.2942, unsigned, undated India Office note written clearly in April 1920.

[89] IOLR L/F/6/1083, F.2942, Howard to Blackett, letter dated 26 May 1920.

[90] PRO T160 18/F.571, "Restrictions on Imports of Gold into India", undated, but written in June 1920; IOLR L/F/6/1083, F.2942, Finance Department note, "Removal of Control over Imports of Gold into India".

would increase only if the sterling-dollar parity rose. This was unobjectionable whereas, if sterling fell, gold imports into India would be checked with favourable results for the sterling. The Indian government would withdraw from the London gold market if necessary. Apart from reducing the India Office's accounting losses on gold transactions (its accounts were in sterling while the gold bought by the India Office was valued at Rs.10 per sovereign), it would ease its Ways and Means position and the funds so released could be used to meet reverses or buy silver. A government withdrawal from the gold market would strengthen the sterling, as the Indian government was buying dollars to finance its gold purchases. On the other hand, if the Indian government continued to buy gold after rupee sales revived at the official parity, the India Office would sustain a loss which could be avoided if private gold imports into India were allowed. Lastly, the memorandum said, such a step would relieve the silver position of the Indian government.

The Treasury's response to the latest India Office plea was on the whole favourable. Blackett conceded that with the rupee weak, controls could be lifted without causing increased gold flows to India. The action would also enable the India Office to get out of a "bad mess". Referring to the undertaking he had already sought informally from the India Office, Blackett said once gold controls were lifted, the Indian private sector would replace the Government of India in the gold market and "in the end (may) demand less". The Exchequer would gain as the India Office would no longer have to let Treasury bills run off; it would also withdraw from the market for dollars. The risks of lifting the restrictions on gold movements to India were "no longer as formidable." He confirmed that the India Office had accepted the Treasury condition that the Indian government would sell gold freely from its reserves, as long as demand for gold existed in India, so that total gold holdings in the reserve were reduced from Rs.440 million to Rs.200 million. Referring to the Americans, he said the Treasury was under no pledge to the United States but the latter should be informed of the action and told that no harm was expected to come out of it. Finally, "I should not object if one of the results of our action was to make the US Treasury more anxious to settle the Pitman silver arrangements ...."[91]

The Treasury condition that the Indian government should sell gold from its reserves is an interesting one and we will dwell on it briefly.

The India Office memorandum pleading for the relaxation of gold controls said that the earlier policy had been to work towards a 2s. gold rupee directly, by using reverse sales to stabilize the rupee. It proposed a new policy which was to "harness exchange and internal gold prices together, at the same time establishing a true and natural relationship between the internal gold price in India and world gold prices." [92] Now the Indian authorities had two objectives - keeping Indian gold prices in line with world gold prices and strengthen the rupee - which on the face of it seemed in conflict. Free gold imports would ensure that Indian gold prices stayed at the same level as world prices for the metal, but would neutralize the positive effect on the exchange rate produced by the sale of reverses. Therefore, the only way in which "exchange and gold prices" could be "harnessed" together was if gold prices in India could be maintained by measures that involved no imports of gold. Only the sale of gold from existing reserves could achieve the two objectives simultaneously. This was the implication contained in the India

[91] PRO T160 18/F.571, Blackett's note to the Chancellor of the Exchequer dated 15 June 1920. India Office acceptance of the conditions imposed by the Treasury is in Howard's letter to Blackett dated 14 June 1920. The decision to lift the embargo on bullion, though not on sovereigns, was taken four days later. See IOLR L/F/6/1083, F.2942, Kisch to Norman letter dated 18 June 1920. Norman, by now the Governor of the Bank of England, was also keen that the Americans be informed. See Norman to Kisch letter dated 21 June 1920. The telegram to the Americans said the "same causes which make these steps necessary now will tend to make improbable any such drain on the world's gold as was feared in February"- Foreign Office Telegram dated 18 June 1920 in the above file.

[92] IOLR L/F/6/1083, F.2942, Finance Department note dated June 1920, "Removal of Control over Imports of Gold into India".

Office memorandum and the Treasury lost no time in making it an explicit condition before it consented to the lifting of the Indian gold controls. As the Controller of Currency said in his report for 1920/1921, the principal objects of the sale were firstly, to reduce the internal premium on gold and thereby establish the new exchange rate and secondly, to support the exchange by reducing imports of gold.[93]

The Government of India accepted the London proposals despite "Bombay" opposition to them. The main basis for the opposition was that government gold sales were checking gold imports and having the same effect as reverse sales.[94] Bombay was broadly right in its analysis of the effects of government gold sales. Not only did they achieve the same objective as reverse sales by reducing the strain on the rupee resulting from gold imports but also, gold sales acted in the same manner as open-market operations in securities by absorbing excess cash balances of firms and households some of which would otherwise have shown up as a demand for sterling.[95] If reverse sales were discontinued, then gold exports could be an alternative form of remittance that would come into use depending on price differentials and transport costs. At any rate, government gold sales would be more likely to lead to gold exports than if no such sales had taken place.

In the event, the Indian government gold sales totalled about Rs.200 million. Gold in the Paper Currency Reserve amounted to Rs.444 million in June 1920 just before

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[93] Para. 18.

[94] IOLR L/F/6/1083, F.2942, Viceroy to Secretary of State, telegram dated 3 July 1920. The India Office also held this view privately. See PRO T160/571, Minute of July 1920 by Howard to which a reference had been made in Chapter One. He rejected a Treasury request for an Indian gold loan because the Indian government would be forced to limit its gold sales programme and resume sales of reverse council bills.

[95] For a discussion of gold sales and purchases as a monetary policy device see J.G.Niehans, "Gold Operations as an Instrument of Monetary Policy", in Quadrio-Curzio, A., ed., **The Gold Problem : Economic Perspectives**, Oxford, 1982, pp.271-280.

the sales began and by March 1921, this had fallen to Rs.242 million.[96]

The gold sale operation succeeded beyond the wildest expectations of the London policy-makers. The fall in gold bullion imports began immediately (despite a relaxation of the controls over them) from July 1920, by when India had begun exporting gold haltingly and in small quantities because of "difficulties of freight."[97] By November 1920, when reverse sales were discontinued, India was emerging as a net exporter of gold (including sovereigns which in some measure must have been distress sales). The Controller of Currency noted in his report for 1920-1921 that a large portion of the gold sold by the government was resold later for export and served to support the rupee.[98] The Currency Office was entitled to this opinion because, between October 1920, when gold exports began in a big way, till March 1921 when the financial year covered by the report ended, total gold and bullion exports almost exactly equalled the amount of gold sold by the government.[99] But, gold exports continued well beyond the amounts released by the government sales and lasted till the last quarter of 1921.[100]

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[96] IOLR V/26/302/7, Appendix V to Appendix 3, McWatters' Memorandum, Vol.II, pp.28-31.

[97] IOLR L/F/6/1084, F.6186, Viceroy to Secretary of State, telegram dated 9 July 1920.

[98] Para. 18.

[99] Gold export figures on which these statements are based are to be found in Government of India, **Report of the Controller of Currency**, 1920-1921, para.9.

[100] Quarterly net gold exports on the private account increased from Rs.33.12 million over October - December 1920 to Rs.114 million in the first quarter of 1921. It declined to Rs.54 million in the second quarter but rose to Rs.72 million between July - September 1921 and trailed off thereafter.
Source: Government of India, **Reports of the Controller of Currency** 1920/21, Para.9 and 1921/22, Para.6. The figures include coin and bullion.

The India Office was however, at the end of this costly period of aborted stabilization, defiant and unrepentant. Howard was "unshaken" in his belief that the 2s. gold rate was right. After salvaging what consolation he could from the events of 1920 such as the avoidance of inconvertibility, reduced fiduciary issue etc., he expressed satisfaction that an improvement in the rupee would not be hampered by gold imports because the "edge" of India's post-war gold appetite had been removed.[101]

Kisch attributed the weakening in the rupee to the extent of revaluation with respect to the sterling, necessitated by the "break" in the sterling-dollar exchange and claimed credit for the way in which the India Office had managed sterling sales "on a scale that had never before been considered practicable ..." This was "proof that the plans (to meet the reverses) were carefully laid." He expected however that the forces making for the disequilibrium would soon ease. There was no need to be apologetic about what had happened, he said. The previous months had not been "barren of fruit". The legislation for a Rs.10 sovereign, the contraction in the note circulation which was an "achievement of deflation (which could not) be dissociated from the policy of selling reverses", the abatement of price increases and the increase in the metallic portion of the reserve were all significant positive developments. The latter must especially be the "envy" of most countries. Inconvertibility was no longer a threat. The restoration of free gold movement was another positive development. He expected that in due course, with the Secretary of State not selling councils and not having to sell them because of the large sterling resources he possessed, the objective of Indian currency policy, i.e., a 2s. gold rate would be achieved.[102]

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101 "Note on the Currency Situation", by Howard dated 17 October 1920.

102 "Note on Exchange and Currency Position", by Kisch dated 5 October 1920.

The note omitted to mention that all the so-called positive results were achieved by methods which averted, for the time-being, the threat that India posed to the gold reserves of the West and to new gold output. Indeed as we have noted earlier, the flow of precious metals was reversed for a brief period at this time. The stringent deflation arising from the grossly over-valued rupee and the liquidation of India's sterling resources were the price India had to pay to avert the threat. Speaking to the Hilton-Young Commission some years later, on the ideal behaviour of a Reserve Bank when it would be established, Kisch spoke of the dangers the bank may face of making losses on the sterling borrowing it incurs to defend the rupee, should such a defense prove ineffective.[103] In these terms, India Office policy in the first ten months of 1920 was not an outstanding example of sensible central banking policy.

A myth about one of the reasons for the failure of the 2s. gold rate remains to be refuted. Testifying again to the Hilton-Young Commission, Kisch attributed the failure to stabilize the rupee in 1920 to the "collapse" of prices in the United States and Britain.[104] This was not quite the case. The fall in world prices between January and September 1920 was hardly significant. The UK price index fell from 289 in January 1920 to 284 in September and the US index from 233 to 226 in the same period. The former actually rose till March 1920 while American prices continued rising till May, that is, long after the rupee began to weaken.[105] The faster fall in the rupee-sterling rate over February - June 1920 than in the rupee-gold rate together with a faster fall in Indian prices compared with British prices may suggest prima-facie that the appreciation of the sterling deflated the

[103] IOLR V/26/302/8, Qn.11265.

[104] IOLR V/26/302/8, Qns.11080-11085.

[105] IOLR V/26/302/7, Appendix VII to Appendix 3, McWatters' memorandum, Vol.II, pp.33-34. All 1914=100.

Indian economy rather more than it did the British one. Since it was improbable that the exchange rate, would deflate more effectively in a country with a smaller traded goods sector than in one with a larger traded goods sector, the conclusion one draws is that, unorthodox fiscal policies mitigated British deflation in 1920, severe though its effects were on employment, while India, as later in the depression remained a theatre of selective economic orthodoxy. In the process, India absorbed a part of the deflationary shocks to which the British economy would have had to be subjected if the sterling was to return to gold speedily and London was to regain its place at the head of the international financial system.

III.4 SUMMARY AND CONCLUSION

It is now necessary to bring together the arguments of the last two chapters in the form of a brief summary. The liquidity crisis engendered by the First World War took the form, for Britain, of a gold shortage or a shortage of primary reserves to finance her external purchases in the war. This, in the main, led to a shift in the distribution of the primary reserve away from the periphery and towards the centre of the global financial system. Further, the centre was, possibly, also disinclined to meet the demands of the private sector on the periphery for gold currency assets because they carried the risk of an uncontrolled portfolio switch and of a deferred demand for gold. But on the periphery, India continued to be dependent on metallic money. Hence a large portion of the burden of financing trade with India was once again thrown on to silver.

In other words, in the face of Britain's primary reserve shortage, silver became an addition to Britain's liquid resources. As Britain could ensure its use on the periphery in a way that the United States could not some twenty years previously (and some fifteen years later), silver also constituted an addition to world liquidity. With limited conversion possibilities however, and confined to financing trade with the periphery, it remained a second-class asset. Nonetheless, at least temporarily, the role of silver as a major monetary metal was restored. The American silver producers were quick to take advantage and together with their political clout, the increased demand for the metal ensured that the price of silver would increase rapidly.

The liquidity problem for Britain was not confined to the war. The war over, the problem for Britain took the form of a shortage of liquid resources to finance post-war reconstruction sufficiently consistent with external equilibrium to speedily restore Britain to the gold standard and the position of London to the centre of the international financial system. Therefore, Britain was keen to ensure that India which, despite commodity trade controls and silver imports during the war, was still feared to have large unliquidated demands for gold, did not drain world gold. At the very least, the latter would have increased the deflationary costs of adjustment in Britain. It might even have resulted in sterling permanently going off the gold standard and in permanent damage to Britain's financial role in the world economy.

Therefore, in the Indian context, the convertibility question expressed the dilemmas of London and Delhi in regard to the need to mitigate India's demand for the primary reserve. The need to fix the rupee at a rate at which silver supplies would be forthcoming arose principally as a way of ensuring that India would continue to absorb silver rather than gold. The deflationary costs in India and reserve losses arising from efforts to stabilize the heavily revalued rupee were therefore considered preferable to the latter's liquidation to finance Indian gold imports. The inflation argument was an afterthought for a course of action that would have been adopted anyway and the Government of India's fear of inflation and their naive, ill-informed belief, in the costless anti-inflationary effects of a high exchange rate enabled London to provide a gloss of virtue to, what was in effect, an extremely self-serving financial policy.

The policy was both a success and a failure from the British point of view. In a period of strong demand for her exports, Indian net gold imports during the war and its aftermath were extremely low by historical standards. She emerged as a net exporter of gold over two financial years and was no longer a bottomless pit for the world's gold. In the seven year period from 1914/1915-1921/1922, India's aggregate net gold imports were only slightly higher than her aggregate net gold imports in the last two financial years before the war, while her net imports on the private account in this period was roughly equal to that in a single good year before the war.[106] The policy fulfilled the short-term objective of averting an Indian gold demand and caused India to dishoard gold. But its effects on the stability of the rupee and India's external balances had important long-term consequences which ruined the credibility of India Office and the Government of India's monetary policy in the years that followed. Monetary policy could no longer be plausibly defended as a technical discipline outside the purview of political debate. Despite India Office resistance, important financial opinion in London came to recognize that steps were needed to restore faith in the political neutrality of monetary policy and institutions in India and, among other factors, this played a role in the evolution of India's monetary institutions in the 1920s. Although the methods employed became more cautious and gradual, the broad aims of monetary policy and the constraints within which it was formulated would remain the same.

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[106] All figures from **Statistical Abstracts of British India**, Cmd.2341, HMSO, London, 1925 and earlier years. These figures exclude the gold exports that took place as gold holdings in the gold standard reserve were liquidated. This, at Rs.90 million (converted at 16d.) was about 12% of the net gold imports in this period.

CHAPTER 4

The Managed Float Regime

It is a paradox in the inter-war economic policy experience of Britain and her colonies that Britain should have ceased to defend the war-time sterling-dollar parity ($4.765), and soon thereafter go off the gold standard, when she was running up high rates of inflation.[1] Sterling's downward float worsened inflationary pressures and was seen as representing the eclipse of the so-called "dear money school" and a setback for those, such as the supporters of the Cunliffe Report, who wanted the adoption of a severe deflationary regime.[2] Susan Howson points out that the immediate reason for abandoning the gold standard was the cost of maintaining sterling at its war parity, apart from the effect of that step on employment. The primary sources "do not support the claim that the British government decided to abandon the gold standard only with the firm intention of

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[1] According to the **Statist** Index Numbers of Wholesale Prices, Britain's rate of inflation in March 1919, when sterling began to float was about 14 percent. By then, British prices had increased far more than American prices in relation to their 1913 levels.

[2] PRO T172/1384 is the well known "Dear Money" file and provides many insights into policy debates in this period. For a discussion of the debate see S.Howson, "The Origins", **EHR**, February 1974, and **Domestic Monetary**, 1975, pp.11-23. The Cunliffe Report recommended severe deflation to restore the pre-war gold standard which the committee, chaired by a former Governor of the Bank of England, assumed rather than established had an incontestable case. See Committee on Currency and Foreign Exchanges after the War (Cunliffe Committee), **First Interim Report**, Cd.9182, HMSO, London, 1918 and **Final Report**, Cmd.464, HMSO, London, 1919.

returning to it as soon as possible."[3] But by the end of the year, even the politicians in government had admitted the desirability of an early return to gold and thereafter, this objective, in the view of a contemporary observer, dominated British policy almost exclusively in her financial relations with the Empire.[4]

We have seen in the introductory chapter, that the sterling's position as a key currency in the pre-war gold standard depended less on British gold reserves (which were insubstantial in relation to her liquid liabilities), than on her ability to control the movement of South African gold and her control over Indian surpluses and reserves.[5] The fact that almost all the gold was sold through the London market meant that it was another line of defence around the sterling. Bear pressures could be deflected away from the Bank of England's slender gold reserves and towards new gold arrivals in London. As long as the major gold producers sought and held sterling, and as long as the collapse of confidence in the sterling was not so complete that new gold arrivals available to foreign monetary authorities and other sterling holders fell short of demand, the Bank of England's interventions could be confined to smaller margins than that of a central bank not possessing a similar advantage. A period of pronounced bear attack not large enough to cause a crisis would then show up in the proportion of new gold arrivals bought by the Bank of England : the smaller its share, the more severe the bear attack, as in the late 1920s.[6]

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[3] S.Howson, **Domestic Monetary**, 1975, p.11

[4] W.A.Brown, **England**, 1929,p.122.

[5] A restatement of this position is to be found in Geoffrey Ingham, **Capitalism Divided**, 1984, pp.125-126.

[6] The Macmillan Committee pointed out (**Report**, paras 165-166) that in 1930, the Bank of England could buy only 1.41 million pounds out of total gold sales of 44 million pounds. Also see PRO T172/1594, note to the Chancellor of the Exchequer dated 22 November 1927 in which Leith-Ross acquaints Churchill with the nature of Bank of England intervention in the London gold market.

In the inter-war period, for reasons already discussed, an important British interest with regard to India was to regulate the Indian demand for gold, the availability of which (as primary liquidity) was crucial to Britain's reduced cost return to the gold standard. Britain's ability to influence Indian private gold demands was somewhat hampered by a number of other factors. Nevertheless, in the view of a contemporary observer, "... important as other gold movements were... it was the movements of metal between these three distant parts of the world (South Africa, India and the United States) through the intervention of the London market which are of chief interest and significance in a study of the restoration of the gold standard after the war."[7]

This chapter is organized as follows. The first section briefly sketches the larger external background to Indian monetary and exchange-rate policy between 1921 and 1924. The second section discusses the policy itself in some detail. The third section continues the above discussion in the context of an institutional question related to the method of securing sterling remittances. This was a somewhat contentious issue in relations between Indian monetary authorities in Delhi and Whitehall and sheds some light on Indian exchange rate policies in these years. The last section leads up to the establishment of the Hilton-Young Commission with a summary of what, in our view, were the chief considerations determining the rate and timing of rupee stabilization.

IV.1 THE BACKGROUND : THE BRITISH LIQUIDITY CRISIS

When Britain left the gold standard formally at the end of March 1919, war-time controls on the gold market were still in place. South African gold was bought by the Bank of England at the sterling parity price of 77s9d per standard ounce.

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[7] W.A.Brown, **England**, 1929, p.42.

Exports of gold from Britain, which during the war had faced an informal check through appeals to patriotism, had resumed before they were formally banned at the end of March 1919. But as sterling depreciated, the Bank of England's official gold price became a fictional one, as it diverged greatly from the price of gold in the world's markets. Protests by the South African gold producers led to an agreement in September 1919 by which, all South African gold continued to be shipped to England and bought by the Bank of England at the sterling parity price of 77s9d and sold at the same price to the refiners. The Rothschilds bought the refined gold and sold it at the market price. The gold producers thus secured the difference between the sterling parity price and the market price. By means of this somewhat convoluted arrangement, the role of London as the international gold market was preserved and the pretence maintained that within Britain, the value of gold had not changed from the pre-war value. In this segregated market for gold, sterling was on par.

But private exports of gold to India continued to be restricted till June 1920, when it was felt they could be safely lifted. The only restriction that remained thereafter was on the direct shipment of gold from South Africa to India. The deflationary impact of monetary policy in India checked her gold demand in 1920/21 and also brought out some of her hoards. China also underwent a similar experience in the second half of 1920. It was not till September 1921 that India emerged in the London market as a net importer of gold. These asset shifts on the periphery were consistent with the British aim of maximizing American gold absorption. The early movement of gold away from the USA, when she lifted her own gold export embargo in 1919, was reversed after April 1920. So successful were the British efforts to direct gold flows towards the USA that in each month between August 1920 and August 1925, the USA was a net importer of gold.[8]

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[8] W.A.Brown, **England**, 1929, p.29.

Britain's aims in increasing American gold receipts have already been anticipated. Briefly, the hope was for a sterling appreciation achieved more by American inflation than by British deflation. The optimistic view was that as USA received gold out of new production, US prices would rise. Besides, USA might be more willing to lend to Europe. If the British rate of inflation was kept below the American one, sterling would rise. As prices rose in the USA the real value of debt payments would also fall. It was a measure of the diminution of Britain's overseas creditor position that far from seeking an anti-inflationary regime, she was seeking to promote an inflationary one.[9]

R.G.Hawtrey, the Treasury economist, was an ardent believer in exporting gold to America. Writing in July 1920 when the tendency of the USA to import gold had not become very pronounced, he said, the only "alternative to a restriction of circulation in America (was) the sending of gold from here." Larger the quantities of gold sent, better. Nothing "could be more favourable to the economic recovery of the world than generous help from Europe to America" by way of gold exports. The reason for this view was that "in essence, the export of gold (was) a device for **lowering the world value of commodities.**" It countered American deflation arising from a scarcity of gold, and its tendency "to **raise** the world value of gold." The problem with this strategy, Hawtrey correctly foresaw, was that it might increase the demand for gold as a commodity. "This is particularly conspicuous in India ... where absorption is expected to be very large." The Indian gold demand, he warned, might necessitate larger permanent deflation. This was a problem for the future.[10]

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[9] D.E.Moggridge, **British Monetary Policy**, 1972, p.46 and pp.81-87.

[10] CCA Hawtrey Papers, Htry 1/13, "Return to Gold Standard", memorandum of July 1920; emphasis in the original.

The British concern that America should receive large quantities of gold had not diminished a year later. If anything, this concern was compounded by another, that, despite excess US reserves of $700 million in the middle of 1921, she seemed no nearer to launching an expansionary domestic or international policy. Stressing that continued deflation was disastrous for Britain, Hawtrey said the dollar had to be cheap and stable if sterling was to return to gold.[11] Britain desired inflation, but could not ease credit on her own for fear of its effect on the sterling. Inevitably, the USA had to take the first step and only she had the ability to influence world commodity prices.[12] But Britain could "hasten in some degree the advent of cheap money in America by sending more gold thither .... A substantial consignment ... would hasten the progress ..., and the **psychological** effect would be greater in proportion."[13]

Hawtrey recognized that Britain was pursuing two conflicting objectives: avoid or minimize deflation and return to gold. These "two objects ... can ... be reconciled (only) by a continuation of the inflationary tendency in America." The USA was moving towards raising her rediscount rates to check inflation and if this was allowed to happen, the tendency of sterling to appreciate would be checked. Therefore it was best to export gold to USA "to create a redundancy of currency there." The payment of debts provided a suitable pretext, but he urged caution so that USA was not provoked into sterilizing her gold receipts.[14]

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[11] CCA Hawtrey papers, Htry 1/13, "Return to Gold Standard", July 1921.

[12] CCA Hawtrey papers, Htry 1/13, "The Rediscount Rate of the American Federal Reserve System", undated memorandum, and S.Howson, **Domestic Monetary**, 1975, p.27.

[13] CCA Hawtrey Papers, "American Exchange", undated, but July-August 1921; emphasis in the original.

[14] CCA Hawtrey Papers, Htry 1/26, "Export of Gold to America", note dated 3 March 1923. Over 1922/23, Britain exported gold to the USA in payment of her war debts. See W.A.Brown, **England**, 1929, pp.137-38 and PRO T176/9, Niemeyer Papers, Blackett to Governor, letters dated 4 July 1922 and 29 November 1922; Norman to Niemeyer, letter dated 3 August 1923 and Niemeyer to Norman, letters dated 4

From the latter half of 1920, as she increased her discount rates, the USA began attracting considerable quantities of gold not only from Britain, but also from other parts of the world. Southern and Central America ceased importing gold and instead (like India and China) became net exporters. Australia also started shipping gold directly to the United States once she found the Indian demand tapering off. In 1921, besides large gold receipts from London and substantially the whole South African production of the metal, the United States received nearly $250 million of gold from France and Sweden which originated in Russia. Thus US net gold exports of $292 million in 1919 became net imports of $95 million and $667 million in 1920 and 1921 respectively.[15]

This trend continued through 1922 and 1923. Net American gold imports in the former year were $220 million and in the latter year, $241 million. The nominal British share in these US gold receipts was large. In 1920, British gold exports accounted for nearly two-thirds of all gold exported to the USA. In 1921, this proportion fell to about 30% especially as France, Sweden, Canada and the Asian countries emerged as large exporters. In 1922, though France and Sweden together exported nearly 22% of all gold received in the USA, the British share was still significant at about 44 per cent. In 1923, Germany emerged as a major exporter accounting for about a sixth of US gold receipts, yet Britain accounted for almost half of them in that year and some 40% in 1924.

While she could not directly force other countries to boost US gold receipts, Britain could and did try to maximize the empire's gold exports to the USA. To accomplish this, she made efforts to ensure firstly, that South African gold production would

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August 1923 and 19 September 1923.

[15] Quoted in W.A.Brown, **England**, 1929, p.117.

not slacken, secondly, that the South African gold would come to London to be sold and thirdly, that other (especially non-monetary) demands on South African gold would be kept to a minimum. As the increase in South African gold production from 7 million fine ounces in 1922 to 9.6 million fine ounces in 1925 shows, Britain was largely successful in her first endeavour. But one outcome of the arrangements made to sustain London as the world's principal market for gold was that, Britain's already fragile control over the South African gold producers weakened further. She had to pay the price of having to allow South Africa to return to the gold standard before the sterling, whose own return was also thereby hastened. Britain's success in her third aim during this period was somewhat mixed and the discussion of it in relation to India is the subject of a separate section in this chapter and the next. However, the final results of her efforts were disappointing from the British point of view. US inflation was not as high nor as consistent as Britain would have liked it to be, though, till the end of 1922, gold receipts might have mitigated the more severe manifestations of US deflation. But sterilization of much of her gold receipts prevented domestic US and possibly, world expansion, and also, they might have in the end served to increase US gold imports and accentuated the maldistribution of gold which was a problem already haunting Britain.[16]

In some ways, in the absence of an US expansion, gold exports to her were inevitable, whatever the aims of the British policy-makers. Britain continued to import heavily from the USA. Her normal trade exports were not being restored rapidly enough and her trade deficit, although lower than during the war, was still high by historical standards over 1920-25. Further, according to one estimate, although India continued to earn dollars for Britain, she stopped underpinning the British current account position in the degree that she had done before the war.[17]

[16] M.Friedman and A.J.Schwartz, **A Monetary History**, 1963, pp.284-285.

[17] J.D.Tomlinson, **Anglo-Indian,** pp.217-18.

Gold exports were therefore necessary to pay for imports whose non-availability may have postponed recovery. Illustratively, Britain's gold exports to the USA accounted for almost 15% of her current account surplus in these years.[18] The latter, although substantial in most years till the depression, was still lower than her long-term capital exports. The unattractive option of having to borrow short in order to lend in the long-term compelled the British Treasury, supported by sections of British industry, to restrict overseas loans. Even so, Britain's overseas lending consistently exceeded her current account surplus in these years. The checks were relaxed in 1927 but were re-imposed after sterling left gold in 1931.[19] Thus,

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[18] B.R.Mitchell, **Abstract**, 1962, p.335.

[19] In fact, in the latter period, Hilton-Young (by now Lord Kennet) was the head of a committee that vetted overseas issues.

On Treasury and Bank of England checks on overseas lending, see A.Cairncross and B.J.Eichengreen, **The Sterling in Decline,** 1983, pp.11-23. In 1922, Hawtrey cited the expansion of British overseas lending as evidence of the restoration of the British external position. See CCA Htry 1/13, untitled memorandum written in October 1922. But by June 1923, when the extent of Britain's dependence on short-term borrowings to finance her overseas loans became evident, he was forced to change his mind. See CCA Htry 1/25, "Industry and Overseas Investment", memorandum dated 22 June 1923. After its return to gold in April 1925, Niemeyer linked the outlook for the sterling to the restriction of overseas issues in London. With a current account surplus of 30 million pounds, he said, Britain could not afford to lend money abroad. Foreign lending earned commissions for the City, increased some British current account receipts, and possibly, increased demand for British goods. These were useful advantages, if Britain could "**afford to acquire them**." But, in his view, foreign lending was not, on balance, beneficial to Britain : if the proceeds were spent in Britain, exports were given away for nothing, and if they were spent abroad, which was "largely the case", Britain might be forced to export gold. Therefore, all borrowers including colonies should be discouraged, "for we do not want bank rate to be put up." See University Library, Cambridge, Baldwin 3, 1925 Budget Papers, Niemeyer's note dated 22 May 1925 and another undated note written probably in the same month. Emphasis in the original.

The British Treasury asked the Colonial Office to urge the Dominions and colonies "not to raise loans" in Britain "owing to the difficulty this might involve as regards the maintenance of the gold standard." See University Library, Cambridge, Baldwin 93, Amery to Prime Minister, letter dated 6 June 1925.

There was pressure from industry to restrict foreign issues or at least tie them, as the French and the Germans were doing, to British goods. But London financiers resisted it because of their fear of the effects of such a linkage on London's role as an international capital market. See IOLR L/F/6/1033, F.5837, Board of Trade Advisory Council, "Trade Outlook and Foreign Loans", A.C.119, "Written Observations of Members of Council", undated but probably April 1925. Goodenough was one of the London financiers who opposed the linkage between borrowing British and buying British. Industrialists welcomed the restriction on gold exports because it favoured the export of merchandise.

It was a measure of the severity of Britain's liquidity crisis at this time that although Britain's (or Europe's) best hopes in relation to US gold receipts may not have been fulfilled, given their (especially British) strategies, requirements and priorities, it is hard to see what else these countries could have done.

In the circumstances when primary liquidity shortages threatened to be an enduring reality for her, Britain tried to reduce the other demands on the world's gold and to make the actual use of the metal conform to her desired use for it. The gold exchange standard has already been discussed. The attempts to reduce the non-monetary demand for gold in India was part of the same effort. These efforts to economize on gold were taking place against the background of the sterling's struggle to return to the gold standard at the pre-war parity and London's striving to retain her financial leadership of the international financial system.. As much as the rate at which the rupee was stabilized, the timing of the stabilization was crucial to the battered monetary unity of the empire and the primacy of the sterling. We now proceed to locate the stabilization policies in India till 1925 in the above context.

IV.2 POLICY IN INDIA, 1921-1924: MOTIVATIONS AND RESULTS

By the end of 1920, the stabilization programme recommended by the Babbington-Smith Committee, formulated under constraints imposed by Britain's own liquidity problems, had failed. The immediate objective of preventing an enormous absorption of gold by India had been achieved. But a price paid for this success was that the

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the Treasury should have gone back on the earlier belief that overseas lending helped Britain through promoting global expansion and sought to restrict it (while urging the promotion of US lending). This was contrary to British policy in regard to Indian gold exports in the depression, whose uninterrupted continuation they sought because of their effects on global recovery.

For other discussions of the British lending embargo, see Clay, **Lord Norman**, 1957, p.144, p.220, L.S.Pressnell, "1925", **EHR**, 1978, pp.78-80, Costigliola, "Anglo-American",**JEH**, 1977, p.927, D.E.Moggridge, **British Monetary**, 1972, pp.206-08, J.M.Atkin, "Official Regulation of British Overseas Investments, 1914-1931", **EHR**, Vol.26, No.2, 1970, pp.324-35.

questions of a permanent exchange rate for the rupee and long-term Indian gold demands were left unresolved. If anything, the collapse of the rupee in July 1921 to less than 12d. gold (about 15d. sterling) made rupee appreciation a certainty in the long-term. As sterling also approached parity, imported gold would seem cheaper in India. This could be expected to accelerate gold imports in the short-term until incomes and prices adjusted to the new rupee parity.

But the rupee parities were themselves not spontaneously determined. They were the product of a monetary policy designed to secure an appreciation, with target exchange rates determining monetary expansion. In that sense, the rupee was never on a free float till its **de-facto** stabilization in November 1924, but on a managed float. The India Office and New Delhi desisted, for the most part, from exchange market intervention, in order to force the rupee up. In a currency system that largely depended on trade financing for expansion, the absence of intervention (either through the sales of council bills or purchases of sterling), rendered expansion arbitrary. The so-called absence of intervention only meant intervention of a different form with a definite objective. Since revaluation was the dominant objective, monetary policy in this period had a pronounced deflationary bias.

This section is organized into two sub-sections. The first briefly examines the movement of Indian and world prices between January 1920, when the rupee approximated to the 2s. gold parity recommended by the Babbington-Smith Committee, and June 1925, when the sterling returned to gold. We also discuss movements of the rupee exchange rate and of Indian trade during these years in this section. The second sub-section discusses the aims of the monetary policy of the Indian government at this time and examines the influence of policy on the exchange rate.

IV.2.A PRICES, EXCHANGE RATES AND GOLD: 1920-1925

Consider the movements of prices and exchange rates between January 1920 and December 1925 in Table **IV.1** below. It is clear that the post-war boom did not peak in Britain till March 1920. The climb to the peak over December 1919-March 1920 was quite rapid. The increase in the rate on Treasury bills from 5% to 6% in early November 1919 did not do much to turn the tide. Over March - May 1920 there was a slight fall in prices and then, a steep fall between May and June 1920. The bank rate in London increased from 6% to 7% in the middle of June 1920, but the immediate effect that it produced on British prices was quite small. The next steep fall occurred after September when it was somewhat more continuous than it had been earlier in the summer. Therefore, though the post-war boom had been checked by May 1920 it was not till the autumn of 1920 that one could detect definite signs of a slump.

This coincides with the American experience and supports the view that the autonomous impact of the British bank rate on British prices (as on the British capital account in this period) was affected by influences emerging from across the Atlantic. The American post-war peak occurred in May 1920 (though at a lower level) with American prices sloping gently off till July 1920 when there was a plunge. A steep and continuous decline in American prices began in September 1920. There was a strong correlation in this period and till 1931 between American and British prices. This correlation was stronger than that between American and Indian prices or British and Indian prices.

Indian prices however began falling as early as February 1920, though, between March and November 1920 the fluctuations were narrow. The Indian peak which was reached in February 1920 was lower than current American or British prices as well as their respective peaks. Even before December 1919 the slowing down of the

TABLE IV.1 PRICES AND EXCHANGE RATES, 1920-1925

M/Y	1	2	3	4	5	6	7
1/1920	289	233	202	192	235	174	137.5
2/1920	303	232	203	188	251	203	145
3/1920	310	234	194	180	238	194	135.5
4/1920	306	245	193	172	259	175	139
5/1920	305	247	190	172	244	170	134
6/1920	291	243	192	173	253	158	127
7/1920	293	241	196	175	264	130	105
8/1920	288	231	193	173	258	141	108
9/1920	284	226	188	173	234	139	102
10/1920	266	211	188	176	227	133.5	97
11/1920	246	196	186	176	215	121	85
12/1920	220	179	179	168	214	115	76
Ann. Av.	283	226.5	192	176.5	241	154	116
1/1921	209	170	169	156	212	108	78
2/1921	192	160	164	151	203	101.5	82
3/1921	189	155	163	149	200	96	77
4/1921	183	148	164	150	202	97.5	78
5/1921	182	145	171	159	199	97.5	79
6/1921	179	142	173	165	186	95	76.5
7/1921	178	141	171	166	185	95.5	73
8/1921	179	142	178	176	187	96	70.5
9/1921	183	141	178	177	178	104	80
10/1921	170	142	178	176	171.5	108.5	83.5
11/1921	166	141	173	172	176	103	83
12/1921	162	140	171	166	175	99	82
Ann. Av.	181	147	171	164	190	100	78.5
1/1922	159	138	178	159	168	99.5	86
2/1922	158	141	179	158	158	97.5	85.5
3/1922	160	142	182	160	158	95	86
4/1922	159	143	182	160	158	95	85
5/1922	162	148	187	161	162	94.5	86
6/1922	163	150	183	166	162	98	90
7/1922	163	155	181	165	169	97.5	88.5
8/1922	158	155	178	160	169	97.5	89.5
9/1922	156	153	176	156	170	97	89
10/1922	158	154	177	151	167	97	89
11/1922	159	156	178	150	168	97.5	89.5
12/1922	158	156	176	149	171	99.5	92.5

Ann. Av.	159	149	180	158	165	97	88
M/Y	1	2	3	4	5	6	7
1/1923	160	156	179	149	169	100	95.5
2/1923	163	157	180	147	173	102	97.5
3/1923	163	159	181	149	172	101	97.5
4/1923	165	159	178	147	171	100.5	96
5/1923	164	156	177	143	172	101	96.5
6/1923	160	153	175	140	167	100.5	95.5
7/1923	155	151	179	140	163	100.5	94.5
8/1923	155	150	171	135	161	100	94
9/1923	160	154	174	136	166	100	94
10/1923	160	153	174	138	169	101	94.5
11/1923	169	152	177	138	172	104	96
12/1923	170	151	179	145	168	101	96
Ann. Av.	162	154	177	142	169	101	95.5
1/1924	173	151	172	142	171	107	94
2/1924	173	152	178	140	186	107	95.5
3/1924	172	150	179	142	209	103	91
4/1924	172	148	174	141	209	104	92
5/1924	168	147	176	141	195	104	94
6/1924	168	145	176	142	200	105	93
7/1924	173	147	179	145	201	106	94.5
8/1924	172	150	180	150	198	109	98.5
9/1924	176	149	179	153	196	107.5	99
10/1924	180	152	181	151	191	110.5	101.5
11/1924	179	153	180	152	181	112.5	105
12/1924	180	157	176	150	185	112.5	107.5
Ann.Av.	174	150	177.5	147	194	107.3	97
1/1925	177	160	171	149	185	113	110
2/1925	177	161	172	149	185	112	110.5
3/1925	174	161	168	151	183	112	109.5
4/1925	169	156	169	149	184	111.5	109.5
5/1925	165	155	164	149	183	111	110.5
6/1925	162	157	157	146	175	112	112
7/1925	165	160	160	147	177	113.5	113
8/1925	165	160	157	146	174	113.5	113
9/1925	164	160	158	145	174	114.5	113.5
10/1925	161	158	160	150	174	114.5	113
11/1925	160	158	164	153	173	114.5	113
12/1925	158	157	163	154	169	114.5	113

Table IV.1 contd.

Ch.4 Table IV.1 contd.

Ann.Av.	166	158.5	163.5	149	178	113	111.7

1. UK **Economist** index number of prices, 1913=100;
2. US Bureau of Labour price index, 1913=100;
3. Calcutta index of wholesale prices, July 1914=100;
4. Indian export price index, 1913=100;
5. Indian import price index, 1913=100 (both indices from IOLR, L/F/5/100-101);
6. Rupee-sterling parity (pence per rupee)
7. Rupee-dollar parity (gold pence per rupee : both from IOLR, V/26/302/7, App.VII to App.3, McWatters' memorandum to HYC, Vol.2, pp.33-34).

rate of growth of Indian prices had become apparent. Indian prices do not seem to have shown much sensitivity to the Indian exchange rate, whatever the lag used. Prices were steady around the 190 mark between March and November 1920 although the rupee fell from about 31d. sterling to about 19d. sterling during this period, which was also characterized for the most part by a downward stability in American and British prices. One possible interpretation is that rupee depreciation protected Indian prices from the more severe effects of the global deflation that was beginning to emerge from the latter part of this period. But the post-November 1920 slump in Indian prices (although it did not last long) took place even as the rupee was falling further. The exchange rate insulation argument could then turn counterfactual to suggest that without a fall in the rupee in the next few months, the slump in Indian prices could have been greater. But there is no evidence from this period that the policy-makers envisaged the exchange rate as an anti-cyclical instrument. The high correlation between Indian and American prices on the one hand and Indian and British prices on the other and the poor correlation between Indian prices and the exchange rate would also seem to confound the above counter-factual hypothesis. Throughout 1921, for example, the small fluctuations in Indian prices did not seem to be related to the exchange rate and if a generalization could be ventured for so short a period covering small changes, then the distinct impression is that Indian prices moved, in relation to the exchange rate, in a manner contrary to that predicted by theory.

Through 1922, 1923 and 1924, Indian prices remained fairly steady around 180, 176 and 177 respectively even though, in the first of these years the rupee depreciated slightly in relation to sterling but rose slightly in relation to gold. British prices stayed relatively unchanged and American prices rose about 15% from its post-war trough which was reached in January that year. In 1923, all the indices stayed roughly steady, though the tendency of Indian and British prices to rise after August 1923 was noticeable while American prices showed no such tendency. In

1924, British and American prices fell till the middle of the year and rose thereafter, though neither movement was large by the standards of post-war fluctuations. Indian prices roughly corresponded to these movements but the rupee rose quite sharply during the year both in relation to sterling and to gold. In 1925 the rupee reached a parity with respect to the sterling and gold of about 13% above the pre-war 16d. rate. Sterling had returned to gold by now. Indian prices began falling slightly before British prices and bottomed out earlier. Therefore, perhaps, they reflected, in part, the rapid appreciation of the rupee since the middle of 1924. American prices stayed relatively unchanged.

Except for the last quarter of 1924, it is hard to make a valid generalization of the effect of exchange-rate movements on price stability in India which can be separated from the effects of the price situation outside India. In the remainder of this sub-section we dwell briefly on Indian trade in this period.

The revaluation of the rupee in 1920 failed against the background of a sharp adverse movement on the Indian trade account. The Indian trade surplus at Rs.1260 million in 1919/1920, was about a third higher than the highest trade balance registered during the war in 1916/1917. However, the high rupee (briefly) and the collapse of the post-war boom resulted in large deficits in the following two years. In 1920/1921, there was a trade deficit of Rs.775 million and of Rs.209 million in 1921/1922. The next three years registered high and increasing surpluses. At Rs.900 million, the trade surplus in 1922/1923 was almost as high as the levels reached in some of the war years, though it was well short of the historical peak reached in 1919/1920. But the next two years saw the overwhelming of that landmark as well. At Rs.1440 million and Rs.1550 million, these balances reflected a surge in the world demand for Indian exports (more than a slackening off of Indian imports) especially as the countries of Europe began to stabilize and revive their economies. Thus, though the post-war slump affected the trade performance of the

Indian economy and the impact of the slump itself was for a period accentuated by exchange rate policy, the collapse of the policy and the collapse of the rupee perhaps saved Indian trade from being exposed to their worst effects.

But the effect of buoyant trade conditions on producers' incomes was mitigated by the behaviour of the Indian terms of trade. India's import prices remained consistently - in relation to their 1913 levels - higher than Indian export prices throughout these years except for three months in 1922. It might seem that if one were to ignore the terms of trade shifts during the war and took only the post-war period into account, the terms of trade had moved in favour of India. Undoubtedly, India's terms of trade improved after August 1920, but the improvement stopped in June 1922 whereafter (we are only now entering the period of Indian trade surpluses), they began to deteriorate. Terms of trade calculations are sensitive to the choice of the base year, but, regardless of the base year used, it would be hard to detect signs of a long-term improvement in India's export prices in relation to those of her imports during this period. In fact it can be plausibly argued, despite a temporary convergence of the two indices in 1929, that the deterioration in the Indian terms of trade considerably pre-dated the depression. The depression only accentuated the severity of the trend.

No relationship seems observable between the Indian exchange rate and her import prices. Indian import prices rose over January-July 1920 as the rupee was sought to be pegged at 2s. gold and fell sharply thereafter, even as the rupee began to fall. Therefore, Indian import prices even in the short-term, did not seem to have been affected by the exchange rate and though, over brief periods, they rose more sharply than British prices or American prices, on the whole, they seemed to have moved more closely with world prices than in relation to the rupee. There were periods during which a depreciating rupee coincided with falling import prices (January 1921 - April/May 1922) while a rising rupee coincided with rising import prices. For a country that played a relatively small role in world trade in respect of most of her tradeables, this is not unexpected and only reinforces the argument that the impact of a revaluation might have been stronger on incomes than on the prices of imports and their substitutes.

The lack of association between Indian trading prices and the exchange rate along the lines suggested by theory may imply that, rather than the exchange rate having the power to influence the terms of trade even in the short run, it was the exogenously given demand and price conditions which determined the terms of trade and further, they caused movements in the exchange rate in the directions they did. The tendency for a rise in the rupee would have been strengthened by buoyant export prices (the period from August 1923 and September 1924 is a good example) while falling export prices may have coincided with a rising rupee because of the effects of a contractionary monetary policy (as for example over June 1922 and November 1923). In the section that follows, we discuss the aims of the monetary policy of the Government of India during this period and the working of policy.

IV.2.B MONEY SUPPLY AND THE EXCHANGE RATE

Even a cursory glance at the circulation of gross coin and notes in India over 1920-1925 reveals the fact that the accent of monetary policy in India was to check the growth of the former. The archival evidence reveals that the official aim was to secure an appreciation of the rupee. Consider for example the following table (Table **IV.2**) which encapsulates the increase in the Indian currency circulation during the First World War and the post-war period in relation to the trade balance.

It is easy to see that the steady growth in the volume of gross coin and note circulation in line with large trade surpluses was reversed after January 1920. The

TABLE IV.2 TRADE BALANCE AND CURRENCY CIRCULATION, 1914-1925

Year	Trade Balance	Gross Coin and Note Circulation September	March
1914/1915	437	605	616
1915/1916	654	638	677
1916/1917	955	715	864
1917/1918	921	1084	998
1918/1919	848	1344	1535
1919/1920	1260	1719	1745*
1920/1921	-775	1576	1661
1921/1922	-209	1784	1748
1922/1923	900	1808	1747
1923/1924	1449	1792	1858
1924/1925	1551	1792	1842

All figures in Rupees Million.

* Rs.1851 million in January 1920.

Source: **Report of the Controller of Currency**, Government of India, various years.

immediate reason for the fall in circulation that took place in 1920 was the attempt to stabilize the rupee at 2s. gold, through the sale of reverse councils that was discussed in the last chapter. As a result of these reverse sales, gross circulation of note and coin fell from Rs.1851 million in January 1920 to Rs.1576 million in September that year. Thereafter, there was an expansion which was especially pronounced in the slack season and which lasted till September-October 1921.

Even if the fall in coin and note circulation over September 1921 - March 1922 is attributed to the trade deficit, the rough stability of the September coin and note circulation figures between 1921 and 1924 and those for March 1922 and 1923 on the one hand and 1924 and 1925 on the other requires comment. The three years between March 1922 and 1925 were good years for Indian trade with large and rising, even unprecedented, surpluses. But the monetary trends do not conform either to expectation or to previous experience.

Over 1922/23 there was an actual fall in gross note and coin circulation during the peak season despite a large trade surplus. There was some slack season expansion between March and September 1922 followed again by peak season contraction between September 1922 and March 1923. Hence, the March circulation in 1922 and 1923 remained unchanged at about Rs.1748 million. There was some expansion again in the 1923 slack season (March 1923 and September 1923). The expansion in the following peak season (1923/24) was through issue of emergency currency that was withdrawn at the end of the season. This withdrawal accounted for the September 1924 gross circulation figures returning to the September 1923 level. A similar policy was adopted in the next peak season. The upshot of this was that gross coin and note circulation expanded hardly at all between September 1921 and September 1924 and only slightly between September 1921 and March 1925 despite large and rising trade surpluses.

That the aim behind this was to secure a rupee appreciation is evident from the Finance Department records of the India Office and the exchanges between Whitehall and New Delhi on exchange rate policy. Both sides agreed on the need to raise the rupee, though there was no coherent view consistently held regarding why it was necessary to secure an appreciation of the rupee beyond the pre-war rate of 16d. gold.

As the rupee fell below 16d. sterling (corresponding to just above 12d. gold) during February-March 1921, Indian monetary authorities in Whitehall and New Delhi had to grapple with the question of whether they should resort to market intervention to prevent a further fall. The Karachi and Madras Chambers of Commerce demanded action and the Government of India argued that intervention would be ineffective in the abnormal conditions that prevailed.[20] The India Office agreed, and acknowledging that the Babbington-Smith Committee had reported prematurely and at an "ill-chosen" moment, said, the persistence of "unsound" conditions meant that stabilization was not advisable in 1921.[21]

Even though immediate stabilization was to be avoided, the India Office had, by the autumn of 1921, come round to the view that action was needed to appreciate the rupee through the continued suspension of council bill sales. Until these sales resumed, and thereafter to the extent left unfinanced by them, home charges were to be met by borrowing in London and contraction of the Paper Currency Reserve. The latter technique of placing the Secretary of State in funds was referred to as remittances through the reserve or transfers from the Paper Currency Reserve. Table **IV.3** below shows the method of financing the Indian home charges between

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[20] IOLR L/F/6/1054, F.5112, Viceroy to Secretary of State, telegram dated 21 February 1921.

[21] IOLR L/F/6/1054, F.5112, memorandum by Kisch and Howard respectively dated 24 February and 25 February 1921 and note by F.W.Duke dated 26 February 1921.

TABLE IV.3 HOME CHARGES FINANCING, 1921-1925

Year	1	2	3	4	5
1921/22	42.8	--	2.5	27.1	14.8
1922/23	40.9	4.77	--	3.3	31.3
1923/24	39.9	23.13	--	5.64	17.5
1924/25	61.9	41.5	--	1.7	18.5

All figures in million pounds sterling.

1. Total sterling expenditure;
2. Net sales of council bills;
3. Remittance through the reserve;
4. Recoveries from the War Office on account of Indian expenditures in the war;
5. Sterling debts incurred.

Source: IOLR, L/F/5/100, Finance Department Statistics, pp.205-206.

1921/22 and 1924/25. As is evident, almost 45% of the sterling expenditure was financed through borrowing.[22]

In the early months after the stabilization of the rupee failed, the 2s. gold parity continued to be regarded as the target exchange rate on the basis of which intervention policy was to be conducted. The Secretary of State reminded the Indian government that "2/-(gold) rupee remain(ed) (the) declared objective of policy."[23] A year later, the India Office continued to hold to this view. Discussing a currency motion in the Indian Assembly seeking a return to the pre-war parity, Kisch argued that unstable world conditions and the adverse Indian trade balance were not conducive factors for a stabilization. Till the latter could be attempted, the policy of non-intervention in regard to exchange "consistent with the discharge

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[22] This fact, more than the actual size of the debt, needs to be borne in mind when discussing the public debt policies of the Indian government in the inter-war period and the departure from fiscal orthodoxy in India. Charlesworth, N., "The Problem of Government Finance in British India: Taxation, Borrowing and the Allocation of Resources in the Inter-war Period", **MAS**, Vol.19, No.3, 1985, pp.521-548 implies that in view of the size of India's external debt in these years, the difference between Indian and Japanese public debt policies was insignificant. But he ignores an important reason for the size of India's sterling debt in these years. Only some of debt was productive. Capital expenditure formed only about 25% to 40% of the total sterling expenditure in the above table and in only one of these four years (1924/25) was it greater than the sterling debts contracted. In 1922/23 and 1923/24, sterling debts were about 31.3 million pounds and 17.5 million pounds respectively. But sterling capital expenditures were only about 10.5 million pounds in each of these two years. A substantial part of the debt was raised to finance fixed current account obligations, in a policy environment in which normal trade financing through sterling acquisitions were kept in abeyance to promote an appreciation of the rupee.

[23] IOLR L/F/6/1088, F.2149, Secretary of State to Viceroy, telegram dated 16 September 1921. This telegram was a reply to an earlier Indian telegram dated 13 September 1921 in the above file which expressed the concern of Indian and European businessmen in India that there were no limits to how far the India Office could push up the rupee, were it so inclined. To side-step a motion by Vithaldas Thackeray for an immediate currency enquiry, the Indian government sought permission to assure him that when a permanent Indian trade surplus was resumed, the monetary authorities would not take action to appreciate the rupee to 2s. gold without seeking the advice of another commission. The India Office refused to permit such a commitment to be made.

of sterling obligations ...." should be continued.[24]

At Kisch's instance, F.C.Goodenough - a member of the Finance Committee of the India Office and the Babbington-Smith Committee-wrote a memorandum opposing immediate stabilization for India, while recommending that it adhere to the statutory 2s. gold rate. The confused memorandum argued that the exceptional conditions, including the uncertainty of future silver prices, that had led to the "alteration" of the rupee in 1920 had not ended. Further, "... if the rupee were written down", the advantage of a high rupee, namely that it would depress prices would be lost.[25] On the one hand therefore, Goodenough seemed to support a de-facto rupee revaluation if silver prices rose, regardless of its effect on commodity prices. On the other hand, he was opposed to a rupee parity lower than 2s. gold because it would affect price stability. Secondly, his argument implied that the mere fact of a 2s. gold rupee existing in law but inoperable in practice acted to depress prices. For, a "writing down" of the rupee from the ruling rate was not under consideration but a move towards stabilization at that level or some level that was closer to it than 2s.. Goodenough was merely invoking the spectre of inflation to oppose stabilization below 2s. gold! Thirdly, Goodenough's price stabilization argument was tenuous at best. When he was writing his memorandum, Indian prices had come in line with US prices at the 16d. gold rate. In other words, Indian prices converted to, what the usage of the period referred to as, "gold prices" at the 16d. rate was in line with gold prices in the USA and sterling prices. A return to 2s. gold at that stage would have required, other things remaining the same, that Indian prices fall some

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24 IOLR L/F/6/1088, F.2149, minute by Kisch dated 5 August 1922. Given the large, even overwhelming, role in relation to the rupee that the Secretary of State played in the exchange market, his abstention could hardly be regarded as enabling the market to adjust spontaneously to normal trading conditions or as not constituting intervention. On the contrary the abstention, was a temporary measure aimed at securing an appreciation of the rupee and therefore was a form of intervention designed to fulfil the purpose in view.

25 IOLR L/F/6/1088, F.2149, memorandum by F.C.Goodenough dated 14 August 1922.

22% from the levels that prevailed in August 1922.[26]

From January 1923, the question of achieving a rupee appreciation merged with that of the location of the sterling purchase operations of the Indian administration and minor skirmishes between Delhi and Whitehall on this subject. To an extent, the timing of sterling purchases and, therefore, the object of securing an appreciation of the rupee was affected by this dispute, though, as we argue in the next section, the shared India Office - Government of India objective of achieving a permanently higher rate for the rupee than 16d. gold kept the dispute from getting out of hand.

IV.3 THE STERLING PURCHASE CONTROVERSY ...

Since early 1920, the Secretary of State had not needed to sell council bills either because there was no demand for them, or in order to enable the rupee to recover from the depths to which it had plunged in 1921. During this period, Indian obligations in London had, as we have seen, been met out of War Office disbursements to the India Office, sterling loans and remittances from the reserve.

Towards the beginning of 1923, the India Office was faced with, what it saw as, a challenge to its financial powers from the Government of India. Both the India Office and the Government of India were in broad agreement on the need to

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[26] Prices and exchange rates for purposes of conversion of Indian prices into gold prices from the same source as Table **IV.1** above. If the increase to 2s. gold was to be secured painlessly through an American inflation, American prices needed to increase some 45%. Otherwise, the rupee would be over-valued in terms of the price index comparisons used.

But price stability was not the indicator that the India Office was looking at to suggest a timing for stabilization. Less than three months after Goodenough's memorandum, Kisch wrote an internal India Office riposte to Stanley Jevons' plea for an immediate rupee stabilization, in which he said that the move would be unsuccessful unless world prices were rising. So, the appreciating rupee, in terms of this argument, was not intended to secure price stability unless we assume that, underlying Kisch's argument was the intention that, the rupee, when stabilized, should be overvalued. For, only an inflationary environment would enable stabilization at an overvalued rate.

achieve a steady appreciation of the rupee and saw their abstention from exchange market intervention as securing that aim. But the deflationary consequences of the revaluation process including the effect on trade of stringency in the market for rupees led to growing opposition within India to the government's monetary policy. Partly in response to this criticism, but partly also to seek greater freedom of action in regard to what was seen as a purely administrative question not involving questions of high finance, the Indian government started buying sterling directly in Bombay from the exchange bankers. The Indian government argued that the normal scale on which council bills were sold made their resumption inconsistent with the revaluation objective. It sought extension of previously sanctioned authority to effect "quiet purchases of sterling when opportunity offers" since more sterling could be bought thereby than if councils were reopened, with a smaller effect on the rupee.[27]

The Indian initiative was well timed. If the India Office did not sell council bills because it wished to strengthen the rupee, it would have conceded the battle over remittances to the Government of India without a fight. On the other hand the India Office could not hope to drive the Government of India out of the market by underselling rupees, without endangering longer-term exchange rate targets for India. So the Secretary of State told Delhi that purchases in India could not be the only method of acquiring sterling and, reversing previous policy, said, remittances could not be subject to exchange rate stability. He announced that council bills would be sold as long as exchange rate variations remained small.[28]

[27] IOLR L/F/7/468, F.16, Viceroy to Secretary of State, telegram dated 23 April 1923.

[28] IOLR L/F/7/468, F.16, Secretary of State to Viceroy, telegram dated 1 May 1923. The Secretary of State, in the event, failed to carry out his threat. Over the next two years, sterling purchases were largely through operations conducted by the Government of India. Of government remittances of 21.84 million pounds in 1923/24, 13.1 million pounds represented Indian purchases. For 1924/1925 the corresponding figures were 40.77 million pounds and 33.19 million pounds respectively. Source: IOLR V/26/302/7, Appendix 3 to Report of Hilton-Young

Two reasons were advanced by the India Office to explain its opposition to sterling purchases in India. An early explanation was that the sale of council bills in London strengthened the "link between Indian Finance and the London market."[29] Kisch later told the Hilton-Young Commission that the India Office needed to control remittances since it could not forecast fund outflows.[30] The exchange bankers also felt that their privileged position was threatened by the new procedure especially as they received no notice of operations. The Government of India, they complained, was buying in a falling market. The bankers, fearing losses, threw their weight behind the India Office.[31]

Basil Blackett, who had moved to Delhi from the British Treasury to become the Finance Member of the Government of India, was the initiator of the changed procedure. His move upset the India Office for several reasons. Firstly, Blackett's timing as we have pointed out, gave the India Office little room for manoeuvre.[32] Secondly, he was no ordinary civil servant in the Indian cadre. A former high-flier

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Commission, Vol.2, McWatter's memorandum, App.II, p.25

[29] IOLR L/F/7/468 F.16, Secretary of State, Despatch of 12 April 1923.

[30] IOLR V/26/302/8, Qn.11702-704. When one considers the persistent India Office desire to secure a rupee appreciation during the period when this controversy was raging, Kisch's reply to the Hilton-Young Commission that India Office sterling purchases enabled the latter to control fund inflows was misleading. What the India Office sought to control, at least till the Government of India began challenging its exclusive monopoly over sterling purchases, was not the size of the fund inflows but the eventual rupee parity.

[31] IOLR Mss.Eur.E397/31, Siepman to Blackett, letter, undated but written in March 1924 and letter dated 22 March 1924; E397/22, Cook to Blackett letter dated 26 April 1923. For some evidence of India Office support for the right of the exchange bankers to be involved in and profit from the financing of Indian trade in a different context, see PRO T160 F.260/2, Lucas to Niemeyer, letter dated 27 January 1920.

[32] While on this point it may be useful to note that the timing of Blackett's move might indicate that the India Office had something approaching a target exchange rate. Given his own sympathies for the revaluation cause, Blackett's confident expectation that the India Office would not endanger this target may also suggest why he acted when he did.

in the Treasury, his experience and contacts within the Whitehall establishment and in the City made him a tougher adversary than his predecessors. The India Office was a "bit afraid" of Blackett and puzzled about his aims.[33] There was also little by way of argument that the India Office could advance in support of its position that sterling purchases, which were only an agency function and did not involve the powers of the Secretary of State, had to be handled by itself. To make matters more difficult for them, Blackett had guarded his flank by securing the support of the Governor of the Bank of England who, while counselling caution, supported Blackett on remittance policy. An Indian Finance Department official under Blackett who was on home leave wrote, after a meeting with Norman, that the latter was looking ahead to a time when, with growing self-government in India, India Office control over Indian finance would disappear. Norman was anxious that a national government should not break away from London in financial matters. He therefore wanted to "forge such bonds" as will keep India within the Imperial (which the official clarified meant the Bank of England's) orbit. To this end, in "matters of form, and also ... in agency business, he is willing ... to make all concessions, so long as he knows that the B(ank) of E(ngland) will be the power behind." Though Norman's motives might not coincide with Blackett's, his correspondent assured him, there could be a temporary alliance between the two.[34]

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[33] IOLR Mss.Eur.E397/22, Cook to Blackett, letters dated 26 April 1923 and 3 May 1923. It was not till his gold standard proposals in 1925, which the India Office seized eagerly to isolate him, and the dispute over the Reserve Bank of India Bill in 1927, that the India Office felt confident of its ascendancy over Blackett.

[34] IOLR Mss.Eur.E397/22, Cook to Blackett, letter dated 13 June 1923. Also see his letter dated 7 June 1923. Blackett had also secured Baldwin's support. See Mss.Eur.E397/20, Baldwin to Blackett, letter dated 1 May 1923.

Quite often, the perspectives and interests of London institutions that oversaw the position of Britain in the global financial system and those of institutions that oversaw one British link with the system was very different. In this case, the Bank of England did not have much patience for the bureaucrats of the India Office but this should not, as Cook's letter cited above shows, be taken to mean that the Bank did not share broadly similar goals as the India Office establishment. A case concerning the Treasury and the Colonial Office illustrates this point. In 1919, the Colonial Bank of Jamaica found its monopoly threatened by a new branch of the National City Bank of New York. They lobbied the Colonial Office for legislation similar to that which restricted the operation of foreign banks in New York. The

What then were Blackett's motives? The evidence does not reveal that Blackett saw his moves as a step towards securing monetary autonomy for India, though, a man of Blackett's experience may have resented having to refer every policy decision to Whitehall for approval, and it may have suited the India Office to react to Blackett as if he were threatening the powers of the Secretary of State.[35] Writing to Hawtrey in the course of this dispute, he complained that "so long as the pedants and old fogies at the India Office sit on the reserves and control the practical working of the Indian currency system, I see no easy prospect of doing any thing effective in regard to exchange."[36] What this suggests is that, despite his possible pique at constraints on his freedom of action imposed by the financial relationship between Delhi and Whitehall, Blackett shared similar goals as the India Office.[37] A gradual rupee revaluation was one such goal. Blackett also realized that exchange market intervention through council bill sales, because of the scale of those operations and the notice given of them, tended to retard the appreciation of the rupee. As remittances were delayed to allow the rupee to rise steadily, monetary

Colonial Office was inclined to agree because of "the danger of economic permeation intensifying American ambitions to own these islands". The Treasury however felt "these small pin-pricks might very likely provoke the Americans into further steps in New York which might be extremely inconvenient to British Banking generally." See PRO T160 77/F.2618, Niemeyer's minute dated 26 May 1919 and Amery to Baldwin, letter dated 20 May 1919.

35 The letters from Cook referred to above warn Blackett against seeming to question the statutory powers of the Secretary of State because, among other things, it would strengthen the India Office campaign against him.

36 CCA Htry 1/3/1, Blackett to Hawtrey, letter dated 1 May 1923.

37 Blackett also shared broader London aims and saw, more clearly than any other civil servant in this period, that the financial realities of Britain's post-war position threatened her survival as an Imperial power. Writing to Benjamin Strong, the Governor of the New York Federal Reserve Bank, he complained that the British government was spending too recklessly. If they did not save, they will lose the markets of the Empire and never be able to reduce internal debt nor lend abroad. Britain must lend to Europe if it must recover and to the Empire if it must remain British, but crucial to this was her ability to save. See IOLR Mss.Eur.E397/32, Blackett to Strong, letter dated 21 December 1927. The similarity between the British problem as diagnosed by Blackett and the American problem today is striking.

authorities, encountering Indian opposition, could either forsake revaluation for remittances or continue as before to finance obligations in London through loans and contraction. Apart from objections in India to the latter course, Indian loans were already proving unpopular in London. There was also the fact that the British government had begun to discourage foreign issues in the London market. Therefore, Blackett's method provided a way of securing remittances while not threatening the objective of a rupee appreciation. Thus, Blackett's remittance policy was above all an ingenious method of reconciling two conflicting objectives. The India Office however felt that the Government of India was seeking greater freedom of action for itself. To the extent it could present the latter in a bad light in the City, it would strengthen the India Office's hands. Nevertheless, its reluctance to let go her control over any aspect of monetary policy was significant.[38]

An important part of the Government of India's argument for buying sterling in India was that, for any given level of remittances, the procedure suggested by New Delhi would produce a smaller depressive effect on the rupee. The India Office was not convinced.[39] The India Office and the Government of India (in different degrees) were both committed to avoiding an excessively rapid rise in the rupee-sterling parity and within this ambit, the India Office offered to supplement council bill sales with sales of intermediates. The Indian government persisted in arguing that only Indian purchases could stop the "compelling urgency" of rapid rupee

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[38] In 1931/32, the India Office tried to reclaim for itself (despite the recommendations of the Hilton-Young Commission to the contrary) the right to buy sterling. The Indian government refused to concede the one power it had wrested for itself from Whitehall in regard to financial matters. See IOLR L/F/6/1175, F.2222, Secretary of State to Viceroy, telegrams dated 23 and 27 October 1931 and Viceroy to Secretary of State, telegram dated 26 October 1931.

[39] IOLR L/F/6/1047, F.2410, Secretary of State to Viceroy, telegram dated 6 February 1923.

appreciation that would have disorganized trade.[40] According to the Government of India, the question was "simply, how to effect remittances at the most favourable rates to the finances of India ...." The future currency policy bore only a "remote connection" to this question and the "best rates" were "secured by keeping supply well behind ... demand, i.e.. by restricting Council sales when demand is not very insistent ..." but ready to take advantage of rising demand.

The argument that the timing of sterling purchases, though its aim was to secure the "best rates" possible for the Government of India, was unrelated to future currency policy is a surprising one. It was clearly a weak case to argue that securing the "best rates" would not require an adjustment of the economy to a gradual revaluation and that the latter would not produce adverse effects on the economy comparable to the favourable ones temporarily produced on government finances. If the Indian government suggested that a gradual rise would not have adverse contractionary effects, then the argument was limited to brief periods and as long as the markets did not form expectations of a steady appreciation. Further, monetary policy in this period was not passive and the rupee parity was being determined not exogenously to the monetary policy apparatus but to a certain extent by it. Moreover, the measure of gradualness suggested by the Government of India - at the lowest, an increase of 1/8d. a week - represented an appreciation of about three-quarters of a percentage point each week, or about 15% in a normal busy season. In practice, revaluation of this magnitude was not achieved, though an appreciation of about 4% (above 16d.) within six weeks and of 6% in a single month took place in the 1923-1924 busy season.

Over February - May 1923 the New Delhi - London exchanges on the sterling purchase question continued, with New Delhi persisting with its argument that

[40] IOLR L/F/6/1047, F.2410, Viceroy to Secretary of State, telegram dated 5 February 1923.

Indian purchases were better designed to take advantage of a rising rupee and sustain it, while sales of council bills would depress the rupee. The India Office sold small amounts of council bills during 1923 since, as it pointed out, such small sales did not depress the rupee. This was a far cry from the earlier India Office position that remittances could not be subject to an exchange rate policy and indicated the hastiness of the earlier position.[41]

In the 1923/24 busy season, Delhi and Whitehall agreed that council bills (in London) or rupees (in India) would be sold only on a rising market. But the latter seemed less inclined than the Indian government, to be rigidly bound to amounts and rates.[42] London wanted to avoid giving the impression that intervention would not occur below 17d. although New Delhi was keen that no council bills should be sold below that rate.[43]

By April 1924, the India Office began to suspect that Blackett would use his new powers of intervention to upstage the India Office in regard to the determination of a permanent exchange rate. An India Office minute emphasized that during one week in April 1924, the Indian government had purchased sterling within a narrow spread, at rates ranging between 16 $^{3}/_{4}$d. and 16 $^{13}/_{16}$d.. These purchases, the minute argued, were heavy for one week and violated London's instructions to buy only on a rising market. The minute conceded that there was need for substantial remittances to be obtained but "in fact the method in which the G(overnment) of I(ndia) have operated for some time past raises a suspicion that they may tacitly have adopted (the objective) of attempting ... temporary stabilization around a series

41 IOLR L/F/6/1047, F.2410, Viceroy to Secretary of State, telegram dated 31 August 1923 and Secretary of State to Viceroy, telegram dated 5 September 1923.

42 IOLR L/F/6/1047, F.2410, Secretary of State to Viceroy, telegram dated 5 December 1923.

43 IOLR L/F/6/1047, F.2410, Secretary of State to Viceroy, telegram dated 12 February 1924 and Viceroy to Secretary of State, telegram dated 21 February 1924.

of arbitrary points, first 1/5 $^1/_4$, then 1/5 and now 1/4 $^3/_4$."[44]

Thus, this little sub-plot, concerning sterling purchases, was being played out against the background of a consensus between the India Office and the Government of India that the long-term aim of policy was to secure a substantial, if gradual, appreciation of the rupee. The India Office hoped initially that, by disavowing any intent to use remittances to secure a revaluation of the rupee, it could appear less vulnerable to Blackett's threat to its powers to sell council bills. But, when a confident Government of India called the India Office's bluff, the latter resumed emphasizing the need to secure an appreciation of the rupee. Thereafter, remittance operations once again became explicitly subject to the target exchange rate.

In January 1923, the rupee reached 16d. sterling (about 15d. gold) and, after staying there almost throughout 1923, showed signs of rising towards the end of the year. Reacting to pressures from Indian politicians and businessmen to stabilize at that level, Blackett told the Associated Chambers of Commerce in Calcutta that a 16d. rupee would encourage speculation. Gold would begin to look cheap, bullion would be imported and India would have the problem of an "appreciated exchange". He also told the predominantly British members of the Chamber that if India stabilized before Britain, she would be subject to American monetary policy influences. Deflation in the USA would lead to contraction in India.[45]

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[44] IOLR L/F/6/1047, F.2410, minute by Carter dated 15 April 1924.

[45] CCA Hawtrey Papers, 1/3/1, Text of Blackett's speech dated 4 December 1923. It was symptomatic of the double-speak that bureaucrats, including Blackett, routinely indulged in that he should have talked of the problems of an "appreciated exchange" and of an US deflation in the same breath. If the US deflated, Indian gold imports would have diminished. What was more in prospect at that time, as any insider within the London financial establishment would have known, and what was more feared in the context of a stable rupee was an expansion, if not of US prices, at least of US lending abroad.

The above was a veiled admission of the motivations underlying currency policy in India during the period of the rupee's float. Consider the case of a country that faces upward pressures on its currency. With fixed exchange rates, these pressures would cause it to accumulate reserves, as it bought foreign exchange or gold to keep its currency within the margins around a fixed par. On the other hand, if the currency was floating, there need not be any increase in reserves, unless the central bank desired to check the rate of appreciation. In effect, Blackett was implying that a decision to stabilize the rupee would lead to larger gold imports, especially (though he left this unsaid) if the Americans inflated their economy, as they were widely expected to do. The consequent accumulation of official reserves represented the problem posed by an "appreciated exchange". Secondly, should the European economies expand under the influence of larger capital receipts from the USA, prices in Europe and Indian exports to the reviving industrial economies could rise. The impact of this expansion on producers' incomes in India would lead to increased private gold imports especially if the prices of India's traditional imports, like cotton cloth, remained high. In the same way as in 1920, but to a much smaller extent, the hope was that, even if an Indian revaluation did not reduce private gold absorption through its effect on incomes, it would nevertheless cheapen Indian commodity imports so that, in the short-term, they might be substituted for gold imports.[46]

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[46] The connection between the trade and the liquidity questions can be highlighted by drawing on a historical parallel. Tomlinson points out that the major British interest in the post-1947 sterling balance negotiations between the British government and the Government of India was to ensure that the latter did not use sterling reserves to finance capital good imports from Britain as they were required to overcome Britain's post-war dollar shortage. She preferred exporting consumer goods to India. See B.R.Tomlinson, "The Sterling Balance Negotiations, 1947-49", in A.N.Porter and R.F.Holland, eds., **Money**, London, 1985, pp.142-62. Tomlinson uses this to refute the nationalist and Marxist view that Britain sought to tie independent India's development to British industry. His evidence merely proves that Britain was unable, because of her dollar shortage problem, to achieve this objective rather than that she did not wish to. If we see Britain's post-war problem in terms of a simple two-sector model, the issue becomes clearer. If all consumer goods are domestically consumed (India being in the sterling area and already possessing accumulated sterling reserves from past exports to the USA putting her in the domestic market for this purpose) and capital goods are the only

Despite Blackett's expressed concern, about deflation in India (under fixed exchange rates) arising from a fall in world prices, the process of securing an upward movement of the rupee itself involved a process of contraction and after October 1924, an autonomous fall in Indian prices. This decline was justified on the grounds that it was a "natural and ... inevitable concomitant of a policy which, whatever other aims it may have, is certainly directed towards raising the rupee exchange at least to 1/4d. gold."[47]

These views were also shared by New Delhi. "If we are to make sure of a minimum" of 16d. gold, a Government of India telegram said and "still more if we are to contemplate that ... the final level of the rupee may be above ... " that figure, "a certain amount of special stringency is unavoidable, since the result of liberal additions to the currency must militate against the appreciation of the rupee."[48] This view was expressed in response to the demand by Indian businessmen that the government ease monetary stringency. In the 1923/24 busy

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tradeables, capital good exports correspond to the domestic savings of the economy needed to overcome a payments crisis. India's imports of capital goods would have affected the ability of the British economy (till further capacity was created, which itself was problematic) to export them for payment in scarce dollars and would, in the circumstances, have been as if British investment (and so British absorption) was being increased by the extent of Indian investment. In one respect, because these Indian investments would have set up an output stream displacing British consumer good exports, they would have been worse. The parallel with gold in the inter-war period is quite close. In the British scheme of things in relation to the composition of Indian imports, gold occupied a position in the inter-war period similar to that occupied by capital goods in the early post-war years.

[47] IOLR L/F/6/1066, F.3729, memorandum by Kisch dated 24 July 1924. The memorandum also found it interesting that the "relative acquiescence" of "Calcutta towards Government currency policy is changing".

[48] IOLR L/F/6/1066 F.3729, Viceroy to Secretary of State, telegram dated 16 August 1924. However at this time, stringency had become so severe that after Indian protests, remittance through the reserve of 2 million pounds planned originally to meet the Secretary of State's home commitments was postponed. See IOLR L/F/6/1047, F.2410, Viceroy to Secretary of State, telegram dated 19 August 1924. Despite this, the gold parity of the rupee rose 7.5% during the slack season and breached the notional 16d. gold ceiling towards the end of September.

season, the Indian currency authorities had issued temporary currency to ease stringency, withdrawing the "emergency currency" as they were known, as soon as the season was over.[49] Even the policy on temporary currency in the peak season, the Indian government asserted, was inseparable from exchange-rate policy. These additions to currency would be made, only if the rupee was not affected.[50]

By the time the 1924/1925 busy season opened, Delhi began to contemplate a **de-facto** stabilization of the rupee. After the rupee touched 16d. gold, Blackett tried to scotch pressures for stabilization at that rate by declaring that the interests of the "consumer" and the "tax payer" had to be considered to see whether a rate higher than 16d. gold would not be more suitable to Indian interests.[51] This was the first public admission that New Delhi was seeking a higher parity than the pre-war one and as was to be expected, it produced protests in India.

These protests led the Government of India to propose to London that a decision should be taken on the level at which the rupee was to be pegged. It considered that the time had come "when we should definitely decide against any attempt to push the rupee above eighteen pence ...." It said that the public had begun to

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[49] As we have seen, the gross circulation of coins and notes at the end of the slack season in 1921, 1922, 1923 and 1924 was largely unchanged. The difference between the first two of these four years and the last two was that in the former period, gross circulation fell through the busy season but expanded after May in the following year to contract again as soon as the busy season began. In the case of the latter two years, emergency additions to the currency ensured some busy season expansion, though the expansionary trend was by no means uniform. There is little direct evidence that the ostensible Government of India concern over inflation played a role in determining exchange rate policy, though from time to time, the India Office supplied price statistics to support a revaluation case. The price argument was advanced after the decision to gradually revalue the rupee was taken. In any case, slack season expansion, by encouraging speculative stock-holding could only have led to increased prices.

[50] IOLR L/F/6/1066, F.3729, Viceroy to Secretary of State, telegram dated 16 August 1924.

[51] Government of India, Central Legislative Assembly, **Proceedings and Debates**, Blackett's reply to Purushottamdas Thakurdas, 19 September 1924.

realise that the market was tight because of induced contraction and opposition to the government's monetary policy was growing. The government expressed the belief that, even if it wished, it could not refuse to provide additions to currency, without provoking a financial crisis. Moreover, the rupee loans programme of the government required that the market be kept easy. Therefore, Delhi proposed that the rupee be capped through sales of council bills, sterling purchases and currency expansion. As long as price stability was not endangered, which according to this view could happen only if the sterling depreciated further in relation to gold, the general policy should be to "fix in our own mind an eighteen pence sterling as the figure at which we desire to stabilize the rupee" and thereafter wait till sterling was on par to fix the rupee by statute.[52]

Several points stand out in the above communication. Firstly, however much New Delhi and Whitehall were committed to contraction in order to secure a revaluation of the rupee, there were political and technical limits to the process which affected Delhi more directly than Whitehall. Secondly, the reference to stable rupee prices and the threat to stability considered, i.e. a fall in the rupee in line with the sterling, suggests that a fall in Indian prices was not worthy of attention. In fact, between October 1924 and June 1925, Indian prices fell 14% when US prices were stable and British prices fell only 6%, but that did not produce any change in government policy.[53] Lastly, it is worth remarking that New Delhi had already decided to dig its heels in at 18d sterling (leading to 18d gold). The Government of India bureaucracy had managed to produce an exchange-rate appreciation (by the end of 1924 the rupee had appreciated 12% in relation to sterling and about 5% to 7% in relation to gold) which, they would claim some months later to the currency

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[52] IOLR Colln.375, F.1, L/F/7/2272, Viceroy to Secretary of State, telegram dated 8 October 1924.

[53] See Table **IV.1** above. Also see IOLR L/F/7/2292, Colln.375, F.1, Viceroy to Secretary of State, telegram of 5 November 1924 admitting to the fall in Indian prices.

commission, represented the equilibrium rate for the rupee. An anticipation of this argument is to be seen in the above Indian communication.

But the India Office was opposed to any attempt to stabilize the rupee at 18d. through unlimited sterling purchases, ostensibly because it would anticipate the outcome of a future committee. We have seen that, in order to avoid giving Delhi the power to buy sterling, the India Office had earlier argued that the rupee parity was not as important a consideration as securing remittances. Employing a similar tactic, the India Office suggested that the "ratio" was not as important as the need to prevent monetary tightness in the market. It proposed that the Indian government adopt a remittance policy that kept down weekly increases to 1/8d. per week while trying to avoid monetary stringency.[54]

But Delhi was adamant and suggested that the rupee could not be appreciated further without damaging Indian exports and evoking fiercer protests in India. The money markets in India were tight and gripped by uncertainty regarding the exchange rate. There were disadvantages in pegging the rupee in advance of a committee, but any other policy involved greater risks. No committee, the communication asserted, would suggest a higher parity than 18d., as it would affect Indian exports and Indian industries. An 18d. rupee would not pre-judge the committee's preferences, but should be adopted even if it did. Further, stabilization was desirable now because " ... the present moment offers an opportunity, which may not recur, of obtaining general acquiescence, even in Bombay, in a policy which will give us a permanently higher rate than one shilling four pence gold."[55]

[54] IOLR L/F/7/2272, Colln.375, F.1, Secretary of State to Viceroy, telegram dated 10 October 1924.

[55] IOLR L/F/7/2272, Colln.375, F.1, Viceroy to Secretary of State, telegram dated 11 November 1924.

At no stage in these communications is it suggested why the India Office and the Government of India were so keen to ensure a "permanently higher rate" than 16d. gold. Further, when Blackett suggested that stabilization at 18d. would secure Bombay's support, he was being somewhat presumptuous. The presumption was based on the observation that some sections in Bombay would be inclined to accept an 18d. rupee as the price of restoring some automaticity to the currency system and taking currency expansion decisions out of the hands of bureaucrats in London and Delhi.[56] Blackett had also cultivated the image of personal independence vis-a-vis Whitehall through his handling of remittance policy. He now used this image to secure a position of greater authority with Indian currency opinion. Writing to urge Purushottamdas Thakurdas to drop two bills that sought restoration of the 16d. parity, Blackett warned him that by pursuing his motion, he would play "into the hands of the India Office, who have always, until I became Finance Member, regarded themselves as the Principals and the Government of India merely as their agents in exchange operations."[57]

The India Office stuck to its positions and throughout the busy season of 1924/1925, discussions continued between the Government of India and the India Office on the subject of busy season stabilization. It would be tedious to follow the minutiae of the communication in any detail. But essentially, the Indian Government position was based on the need to ease stringency in the markets in India (to take the sting out of Indian business protests and to secure the government loan programme) and

[56] IOLR L/F/6/1076, F.2558, note by Kisch dated 30 May 1925 to A.Hirtzel. Kisch was reacting to a Government of India telegram suggesting the above. Kisch remarked, the "disposition even in Bombay to compromise is noteworthy." For another example of the revaluation-automaticity trade-off by Indian businessmen, see NMMA PT Papers, File 55, Part 1, P.Thakurdas to Gandhi, letter dated 27 February 1927.

[57] NMMA PT Papers, File 47, Part 2, Blackett to Thakurdas letter dated 28 July 1924. He did not give any reasons for his fear. But Bombay businessmen thought the Indian government's freedom of policy was not real. See IOLR L/F/6/1076, F.2588, Indian Merchants Chamber to Secretary, Government of India, Finance Department, letter dated 21 May 1925.

the belief that further revaluation would extract a high political price and cause excessive distress to trade. By the end of 1924 the Government of India had come around to the opinion that it was politically necessary to propose a currency inquiry. The currency authorities would then have the advantage, it felt, of being able to determine the composition of the committee such that it reflected their own views. If the committee was delayed it might eventually have to be comprised of members "much less suitable than the ones we desire."[58]

The essential India Office position was somewhat less consistent. But their reasons involved avoiding any limit on the freedom of action to decide the peg, though why this freedom of action was to be desired was never spelt out in clear terms. The threat to "internal price stability" of an early peg was suggested from time to time though at one stage, the India Office also claimed to be waiting for a climate of rising prices before stabilizing the rupee. Despite its opposition to either **de-jure** or **de-facto** stabilization, the India Office was keen to ensure that the Government of India accepted a level around 18d. as the floor for the rupee.[59]

The India Office recognised that the Indian government did not seek to stabilize the rupee in advance of the sterling's return to gold but felt that it was envisaging "the ultimate rating of the rupee with a greater degree of precision than at present

[58] IOLR L/F/7/2272, Colln.375, F.1, Viceroy to Secretary of State, telegram dated 5 November 1924, Part 3 and Viceroy, to Secretary of State, telegram dated 14 December 1924.

[59] IOLR L/F/7/2272, Colln.375, F.1, Secretary of State to Viceroy, telegram dated 15 October 1924. IOLR L/F/6/1047, F.2410, minute by Kisch dated 28 February 1925 suggested that in the forthcoming slack season, as demand for rupees slackened, sterling should not be bought below the peak season rates. The India Office wanted to ensure that the Government of India did not act to keep the rupee down during the slack season. Secretary of State to Viceroy, telegram dated 21 April 1925 presumed this was the case. As Baxter in his minute of 30 April 1925 pointed out, this presumption "was only a gentle way of making a stipulation."

suggests itself to us."[60] This was not acceptable in view of unstable world conditions which, shorn of exaggeration, meant that the sterling had not returned to gold. Kisch laid down three conditions that would have to be satisfied before a rupee stabilization could be considered: a "substantial export balance", sterling's stability after it returned to the gold standard and the stability of world prices.[61] But despite the best efforts of the India Office, the rupee stayed at the level at which it had been when Kisch wrote his above note. The rupee touched 18d. in October 1924 which translated into 18d. gold when the sterling returned to gold in April 1925. During the 1925 peak season the rupee was held at that rate, despite the India Office desire for a further appreciation, largely at New Delhi's insistence. The rupee showed signs of weakness after March 1926 which necessitated reverse sales and currency contraction again. Nevertheless, the Hilton-Young Commission- as we examine in the next chapter - decided to stabilize at the prevailing 18d. parity.

IV.4 SUMMARY

It is now necessary to secure a perspective of what the primary sources reveal. Firstly, the Indian monetary authorities in London and Delhi recognised that the

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60 IOLR L/F/7/2272, Colln.375, F.1, Secretary of State to Viceroy, telegram dated 15 October 1924.

61 The last condition was really another way of stating the second one. IOLR L/F/6/1047, F.2410, "Notes on the Present Position of Indian Exchange with reference to Recent Telegraphic Correspondence with the Government of India", dated 14 November 1924. Incidentally, Kisch's apparent scepticism regarding the sterling's ability to remain on gold upon its return, evident in the above note, did not prevent him from recommending, earlier in 1924, that Indian reserves be invested in sterling securities, that, by Kisch's own admission, could depreciate. Secondly, scarcely months after sterling returned to gold the India Office was suggesting to the Hilton-Young Commission that a peg to gold was identical to a peg to the sterling. The constant shifting of the goal posts in pursuit of specific objectives as the earlier arguments advanced to justify them became invalid, characterised India Office, and to a certain extent, Government of India attitudes towards monetary policy in India in the inter-war years.

18d. rate was achieved through severe contraction.[62] Secondly, the argument that a rupee appreciation merely signified the desire of the Indian government to reduce the cost of sterling transfers is obviously unsatisfactory for the reason that we have already mentioned in an earlier chapter - namely that it clashed with the neutral money argument elsewhere used by the government. Certainly, in the short-term, more especially when the government was trying to balance the budget as in 1921/1922 and 1922/1923, the desire to reduce the rupee cost of the sterling transfer may have played a role. But by the time the Government of India adopted $17^1/_2$d. in the 1924/25 budget and 18d. in the 1925/26 budget, the immediate fiscal pressures had eased. Even on empirical grounds, let alone the theoretical, budgetary pressures could not be cited to justify a revaluation. In 1923/1924, an estimated revenue surplus of Rs.4 million became an actual surplus of Rs.15 million and the Indian government had to rig the budget to hide the increase![63] In 1924/25, an estimated surplus of Rs.1.8 million became a final surplus of Rs.40 million.[64]

Nor was the price explanation satisfactory. Indian prices do not seem to have responded significantly to exchange rate changes. Secondly, there is no evidence that the price stability factor played a consistent role in the arguments in favour of a higher rupee. The India Office used the price stability argument only intermittently and as we show below, by revaluing the rupee, the Indian monetary authorities hoped to encourage the Indians to consume more commodity imports and

[62] SeeIOLRV/26/302/8,KischtoHilton-YoungCommission,Qn.11830,Blackett to Hilton-Young Commission, Qns.10479-480; SOAS Addis Papers, Pp. Ms. 14/557, Draft Reply to Brunyate dated 12 November 1926; NMMA, PT Papers, Madon to Purushottamdas Thakurdas, letter dated 30 March 1926; IOLR L/F/6/1047, F.2410, "Note on the Present Position of Indian Exchange with reference to Recent Telegraphic Correspondence with the Government of India", by Kisch dated 14 November 1924.

[63] IOLR L/F/6/1071, F.5731, McWatters to Under-Secretary of State, letter dated 3 October 1924.

[64] IOLR L/F/6/1075, note by Kisch dated 9 March 1925.

buy less gold. The confusion within the India Office establishment over the price argument is apparent from the fact that while it was suggested that a rupee appreciation was necessary to preserve price stability in India, a recently retired member of the India Office Finance Committee justified a higher rate to the Hilton-Young Commission, because India's rates of inflation were lower than the world rates of inflation.[65]

We are now left with explanations for a rupee revaluation that either figure only marginally or are referred to tangentially in the records. There are two distinct questions that need to be considered.

The first question is, of course, the exchange rate for the rupee. Why did the India office and the Government of India seek a higher rate for the rupee than the pre-war rate? The second, somewhat related question is, why did the two bodies defer stabilization till the sterling had returned to gold, but not at all thereafter?

It is necessary to refer back to our earlier discussions of the developments in the international financial system in the years after the war. In the light of the British desire to maximize gold flows to the USA (and reduce other demands for gold) a floating rupee yielded the advantage of reducing the Indian demand for the metal. Rather than soaking up reserves (in this case, gold) to keep the rupee below the gold import point in an expansionary global environment, the Indian monetary authorities could let the rupee appreciate. Certainly, had stabilization been accomplished say, in 1923, sales of council bills could have ensured that some of the reserves accumulated to keep the rupee within the gold points would have been in the form of sterling rather than gold. But in the unstable conditions, a link to the sterling and a large role for the sterling as an intervention medium in the Indian

[65] IOLR V/26/302/8, Brunyate to Hilton-Young Commission, Qn.11471.

currency system would have been hard to justify. Further, council bill sales could never have completely eliminated gold movements to finance trade, especially when the sterling float yielded flexible margins of intervention which in certain circumstances, would have made gold exports the preferred form of remittance to India. Further, an US-induced global expansion was still in prospect in 1923. If the Indian monetary authorities denied themselves the freedom of exchange-rate policy, they would lose an instrument to check or regulate the composition of Indian imports during the boom.

The extent of the British concern to prevent South African gold going to India is evident from the ban imposed on its direct shipment to India till August 1923. The ban was lifted because of protests from the South African gold producers. Large amounts of gold began to move directly from Durban to Bombay and became a source of worry for the British Treasury. There were problems in India drawing gold from New York as well. Firstly, it would result in a diversion of American gold reserves from the preferred British use for them. Further, to the extent these gold imports were financed in sterling, they would have weakened it in relation to the dollar.[66]

Despite Norman's apparent scepticism, the relation between a higher exchange rate and the composition of Indian imports was quite clear in the minds of India Office and Government of India officials. They told the Hilton-Young Commission that India's high gold imports owed to the high price of her imports of manufactures. Blackett conceded that four good monsoons had kept the prices of India's exports down while the prices of the cotton manufactures that India imported had remained

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[66] L.V.Chandler, **Benjamin Strong**, 1958, pp.322-323, cites a letter from Norman to Strong, dated 8 May 1925 which reflected this concern. The letter said India had drained 1.5 million pounds of gold since the sterling returned to the gold standard and India, " ... almost irrespective of the exchange, is a great absorber of gold ...." Kisch thought the Indian gold demand was "exceptional" because it was private, non-monetary demand. See IOLR V/26/302/8, Qn.11036-11044.

high.[67] If the revalued rate had no role, contrary to earlier suggestions, in keeping Indian prices down and the latter were held down by four consecutive good monsoons, then the only role that an exchange rate appreciation could have played in regard to prices would have been through reducing the prices of India's imports. For good measure, they would also shift the Indian demand for imports away from gold.

The desire to reduce the quantities of gold flowing to India partly explains the delay in stabilizing the rupee as also the decision to have a "permanently higher rate" for the rupee than 16d. gold. The latter would only have a short-term or a medium-term effect till price adjustments were achieved, but Britain's own adjustment problems were mostly viewed as a short-term problem in this period.

There was another reason for deferring stabilization in India till sterling returned to parity with gold. This related to the need to prevent the Empire countries from pegging their currencies to gold ahead of Britain. The British fear was that in the latter event, sterling would be left as the only "paper currency" in a world of gold currencies, to its own detriment and to the benefit of the dollar.

For example, Norman told the Chamberlain-Bradbury Committee that if sterling did not return to gold at an early date, the movement towards the dollar would become unstoppable. The Far-East, South Africa and Australia had already moved away from the sterling and if the European countries also stabilized on gold, Britain would be left out of the re-established gold standard. Charles Addis told the same committee that the financing of the Far-Eastern trade was increasingly passing into American hands. Walter Leaf, a representative of the Committee of London Clearing Banks said that if Germany got the Dawes loan and fixed the mark to gold (as she

[67] IOLR V/26/302/8, Qns.10878, 29-33 and 434; IOLR V/26/302/7, Appendix 4, McWatter's memorandum, p.40.

eventually did), the sterling would be "squeezed out between the dollar and the mark ...." He warned that the US Federal Reserve "have shown clearly their intention to take advantage of that position to get the dollar bill to supplant the sterling bill."[68]

Hawtrey was equally outspoken on the dangers of a floating sterling in a gold standard world. In a memorandum drafted in January 1925, he said (reflecting the contemporary wisdom) that in order to restore the "business of London as a world clearing centre, the essential condition is that a sufficient number of foreign currencies should be very nearly fixed in value in relation to the sterling." This could not be done if the sterling was floating. Most countries desired to stabilize with respect to gold. "Only Egypt, Danzig and some parts of the British Empire are definitely stabilised in terms of sterling without regard to gold." As more countries went on to gold, the trend might catch on and the "transition to a general gold standard may be a very short one, and London may be left isolated with a paper currency in a gold-using world." All the gold standard countries would then be able to finance trade with one other without the exchange risk peculiar to bills drawn in sterling.[69]

By early 1925, South Africa was threatening the monetary unity of the Empire. The Kemmerer mission (led by the Princeton Professor of Political Economy, E.Kemmerer) went to South Africa late in 1924 and, in common with its prescriptions to the other countries it had visited, recommended a gold peg and the establishment of financial links with New York. In January 1925, against British

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[68] PRO T160 197/F.7528/02/1, Montagu Norman's evidence to the committee dated 27 June 1924. L.S.Pressnell, "1925: The Burden of the Sterling", **EHR**, Vol.31, No.1, 1978, p.77 points out that like the Australian banks, South African banks also shunned London balances as they feared losses from sterling depreciation.

[69] CCA Htry 1/23, "Sterling and the Gold Standard", undated memorandum written in January 1925. See also CCA Htry 1/26, "The Gold Standard", confidential memorandum by Hawtrey dated 2 February 1925.

advice, South Africa accepted these recommendations and opted for a return to the gold standard in advance of the sterling. Australia also made similar threats. A British Treasury memorandum emphasized that if the sterling depreciated after Australia returned to gold, the Australian dollar would remain pegged to gold.[70]

British Treasury officials utilized the fear of London losing financial pre-eminence to New York, to stampede a reluctant Chancellor of the Exchequer, Winston Churchill into supporting an early return to gold. Early in 1925, when Churchill questioned Niemeyer on US gold exports to Australia and India, the latter used it as a peg to hang another argument in favour of an early return to the gold standard. He explained that the demand for US gold arose because of the discount on the sterling with respect to the South African pound and gold. Therefore, when India was not buying in South Africa, she bought in the USA. "This is not a bad illustration of what happens when Dominions are at par with gold and London is not. The Dominions deal with US as a centre and don't leave their sterling in London."[71] As Hopkins remarked, while preparing his evidence for the Macmillan Committee, if London had not returned to gold in 1925, the Dominions would have done so on their own. London would then have lost touch with many markets as also her "financial pre-eminence", both "to the gain of the U.S."[72]

Therefore, India's return to the gold standard ahead of herself would not have been acceptable to Britain. When Blackett talked of the rupee being tied to the chariot-wheels of the American Federal Reserve, he was merely suggesting that, apart from

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[70] Costigliola,"Anglo-American",**JEH**,1977,pp.923-926;L.S.Pressnell,"1925", **EHR**, 1978, p.67, p.80; W.A.Brown Jr., "The Conflict of Opinion and Economic Interest in England", in S.S.Pollard ed., **The Gold Standard**, 1970, p.46.

[71] PRO T172/1499B, Niemeyer to Chancellor of Exchequer, "Recent Gold Exports from USA", memorandum dated 5 February 1925.

[72] PRO T176/46, "Gold Standard and Rationalization", undated notes by Hopkins for the Macmillan Committee.

being unable to pursue a stabilization policy in league with Britain, India would be pulled away from the orbit of the sterling and towards the dollar. An Indian stabilization ahead of the sterling would have also increased pressure on London for an early return to gold. There is no evidence of official pressure from India to secure an early British return to gold. In this respect, the Indian case differs from the Australian and South African ones and reflects, perhaps, the greater freedom of policy that the latter two countries possessed. In contrast, the more pliant disposition of the India Office and the Government of India on the timing of rupee stabilization stemmed essentially from a desire to protect the position of the sterling. The references to "world conditions returning to normal" before attempting a rupee stabilization were merely a way of representing the long wait for sterling's return to gold.

CHAPTER 5

The Gold Bullion Standard and a Modest Revaluation: The Hilton-Young Compromise

The Hilton-Young Commission was the last of the currency inquiries in British India. Even while continuing to follow policy objectives similar to earlier committees, it was distinct from them in some respects. For one thing, this commission had four Indian members while the earlier inquiry committees had had either one Indian member each, or none at all. For the first time too, the Hilton-Young Commission went to India to take evidence. Both reflected the fact that, by 1925, currency opinion in India had become recognizably polarized and concessions had to be seen to be made to "moderate" opinion. The shift in the balance of financial power between the United States and Great Britain also finds reflection here. Only six years previously, at the time of the Babbington-Smith Committee, the contribution of the American witnesses had been confined to estimating the likely US demand for Indian exports and forecasting the probable US attitude towards gold outflows. But the New York Federal Reserve Bank sent a strong delegation headed by its Governor, Benjamin Strong, to give evidence to the 1926 commission. Their views and those of the other American bankers who appeared before it, were crucial to the commission's rejection of a gold standard for India.

The official records related to the work of this commission provide some insight into the considerations determining its composition. In the first section of this chapter, we discuss this evidence. In the run-up to the commission deliberations, the Government of India surprised official and non-official opinion alike in London by proposing a gold standard for India. This proposal and the London reaction to it are discussed in the second section. The third section deals with the exchange rate for the rupee and the administrative action taken to make one rate or the other stick. The fourth section discusses briefly, the course of policy and events in the years after the Hilton-Young Commission reported, until the onset of the depression. The last section summarizes the chapter.

V.1 THE MAKING OF A COMMISSION

It is often assumed that technical bodies such as currency commissions and others that recommend courses of action on economic or financial questions are made up of "experts". Implicit in this is the view that they were neutral, dis-interested individuals who pondered their subject only from the standpoint of the general public interest.

The experts who served on such committees undoubtedly believed global welfare-maximizing models (to which they often alluded) to offer the best recipe for prosperity in the poorer regions of the world. On the other hand, they were not theorists in the accepted sense of the term. Mostly, they were practical men of affairs in Britain tackling problems in their own areas of experience and responsibility and shaped by them. Members from the Universities were to be found infrequently or not at all, Keynes' membership of the 1913 commission being the exception. Academic economists were consulted, but often only to confirm the prevailing prejudices of the practitioners' orthodoxy.

For example, the most influential member of the Hilton-Young Commission was Henry Strakosch. The Secretary of State for India was particular about his inclusion.[1] Hilton-Young reported from Bombay that Strakosch was leading the party of "orthodoxy and the economy of gold" in the "Battle of Standards".[2] Kisch had earlier cited "impartiality" as the most important eligibility condition for a seat on the commission and had opposed Purushottamdas Thakurdas' membership, because he had strong views on some of the issues involved. But there was no secret about Strakosch's own views on some of the questions which were likely to come up before the commission.[3]

A former banker with extensive South African interests who had by now secured himself as an insider in the London financial establishment, Strakosch's orthodoxy in this period was well known. An early supporter of the sterling's return to gold at the pre-war parity, he perceived an imminent gold shortage at a time when this concern was not yet widely shared. But, in his early exercises, he did not distinguish between the long-run and short-term aspects of the problem. At the 1920 International Financial Conference in Brussels, he called for deflation to halt the decline in gold production and to prevent its use for non-monetary purposes.[4] In later years, he became a convert to the orthodoxy of the gold exchange standard and was associated with the Genoa initiatives to conserve monetary gold. He was also a close friend and adviser of Montagu Norman, the Governor of the Bank of England.[5]

Though a man of practical experience, Strakosch did not satisfy Kisch's criteria of

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[1] IOLR L/PO/2/3(i), Birkenhead to Prime Minister,letter dated 26 June 1925.

[2] University Library, Cambridge, Baldwin Papers 102, letter to Baldwin dated 11 December 1925.

[3] IOLR L/F/7/2275, Colln.375, F.4, note by Kisch dated 2 April 1925.

[4] PRO T160/52, F.1780, Appendix E to **Report of the Indian Delegates**, International Financial Conference, Brussels, 1920.

[5] Andrew Boyle, **Montagu Norman**, 1967, pp.204-205.

"impartiality" or of not being "deeply committed" in regard to the main issues.[6] However, his biases, unlike those of Thakurdas, conformed to the predilections of the London financial establishment. Kisch's note also said that the commission was to consider issues of "high policy". Therefore, in formulating monetary prescriptions for India, it should keep in view that "external factors (were) at least as important as local ones". To ensure this perspective it was necessary to have "adequate representation" from Britain.[7] Strakosch was the main British representative.

The same note spoke of the need for a "strong Chairman, who can be relied upon to ensure that the deliberations of the Committee are not unduly influenced by political considerations." The Chairman so appointed at the instance of Prime Minister Baldwin was E.Hilton-Young.[8] A former junior Treasury minister who now edited the **Financial News**, Hilton-Young supported sterling's early return to gold and later defended the move from Keynes' attack.[9] He was also committed to the new London orthodoxy of a gold exchange standard. Hilton-Young was therefore a person quite intimately linked in a practical and personal sense to the City of London and its interests. He was also not unaware of the implications for London of some of the proposals argued before his commission. He wrote to Baldwin from

[6] IOLR L/F/7/2275, Colln.375, F.4, Kisch's note dated 2 April 1925.

[7] IOLR L/F/7/2275, Colln.375, F.4, Kisch's note dated 2 April 1925. However, only five months later, the India Office was to discount the importance of nationality in the choice of members. When Delhi proposed the inclusion of a fifth Indian member so that the English and Indian contingents were equal in size, the Secretary of State thought the commission was "already overloaded with Indians". Kershaw noted that a technical committee should have people because of their competence and not because of their race. In Kershaw's note the hint of divergent Indian and British interests, that existed in Kisch's note and which survived in the Secretary of State's telegram, disappeared. See IOLR L/PO/2/3(i), Viceroy to Secretary of State, Private and Personal telegrams dated 10 and 26 September 1925; Secretary of State to Viceroy, telegram dated 12 September 1925; Kershaw's note dated 29 September 1925.

[8] University Library, Cambridge, Baldwin Papers 102, letter to Secretary of State for India dated 29 June 1925.

[9] The **Financial News** dated 31 July 1925.

Bombay that Blackett had thrown a "prodigious brick into the peaceful waters of official orthodoxy" by siding with the "nationalist demand" of a gold currency. He added, "(you) will see, ... that it is not without its possible reactions upon our own situation at home."[10] Together with Mant (who was a long-serving official at the India Office) and Strakosch, Hilton-Young represented the cutting edge of City and Whitehall orthodoxy on the commission. Kisch also expected that, despite Thakurdas' presence (which rendered it "more difficult"), Hilton-Young and Strakosch would be able to exert "control (over) the Indian members."[11] The other two British members, Alexander Murray and W.E.Preston represented the exchange bankers.

V.2 THE GOLD STANDARD CONTROVERSY

In the background of Britain's liquidity concerns in the 1920s, the Indian government's gold standard proposals came as a bolt from the blue.[12] The proposals were unexpected also because, ever since the Chamberlain Commission, it was thought that the proponents of a gold standard for India had been marginalized. In the Babbington-Smith Committee, the Government of India representative, M.M.S.Gubbay, the Indian member D.M.Dalal and a few witnesses including a former Finance Member of the Government of India favoured a gold standard with full-bodied gold coins in circulation. Despite objections, the 1919 committee was forced by the prevalent conditions of the world silver market and the threat of rupee inconvertibility to recommend a fall-back gold standard and gold coin for India. But, as already discussed, the scheme's implementation was postponed indefinitely and in the months that followed the report, it became inoperable.

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[10] University College, Cambridge, Baldwin Papers 102, Hilton-Young to Baldwin, letter dated 11 December 1925.

[11] IOLR L/F/7/2275, Colln.375, F.4, Kisch to Hirtzel, letter dated 18 June 1925.

[12] IOLR L/F/7/2278, Colln.375, F.7, Kisch to Blackett, letter dated 1 January 1926.

Ever since, the gold standard scheme had been propagated only by nationalist opinion. It therefore came as a surprise to everyone in London that the Government of India had fired the first salvoes in what might have been expected to be a minor controversy marked by a gold standard "fatigue". It was all the more surprising that an active proponent of the scheme was Basil Blackett, Finance Member of the Government of India, who, until then, had had impeccable anti-gold standard credentials - having actively opposed the Indian gold standard in 1920 and initiated the Genoa proposals on economizing monetary gold.[13] The consternation that the Indian gold standard proposals - and Blackett's association with them-caused in London is a rich source of material on the subject.

Why did Blackett favour a gold-standard and gold currency for India? It cannot be that Blackett's day-to-day experience with financial problems on the periphery blinded him to the realities and concerns of the centre. His stint in India only seemed to have sharpened his insight into Britain's financial problems. We have already referred to Blackett's letter to Benjamin Strong in which he said that Britain's ability to retain financial leadership of the Empire and of the world in general would depend on whether she made the necessary domestic economic adjustments.[14] Therefore, Blackett must have had a powerful reason to support the Indian gold standard proposal, despite fears that its acceptance would accentuate the difficulties of adjustment to the very conditions that he had diagnosed in his letter to Strong.

Blackett's arguments in support of a gold currency may therefore be briefly summarized. In the same letter to Strong, he argued that the rest of the world

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[13] CCA Hawtrey Papers, Htry 8/3, Draft Article for **The Banker,** May 1969.

[14] IOLR Mss.Eur.E397/32, Blackett to Strong, letter dated 21 December 1927.

was not "... sending less gold to India by rejecting my plan. On the contrary you increase the strain in the end." He said both Norman and Strong knew that they held gold reserves in excess of what they required but would not acknowledge it. They could both do more to educate the public at home to manage with less gold, while he had to give the Indians gold before they could realize that they did not need it.

Confessing to Niemeyer that he arrived at the gold standard idea "rather to my surprise and somewhat against my will", Blackett maintained that the threat from India to the gold standard countries could not be fully eliminated.[15] But, he and Denning argued, their proposals would, if adopted, lead to a quicker acceptance of notes and a lower demand for gold in India in the long-run.[16] Although "wasteful and expensive", India had to pass through the "intermediate stage" represented by a gold currency before arriving at the ideal of an externally convertible paper currency. Gold circulation would "inspire confidence and ... provide the stimulus ... for (the) investment and the banking habit."[17] Lastly, a gold standard would liberate the rupee from the mercies of silver.

Blackett's views in support of a gold standard in India accorded closely with "nationalist" opinion. On the Babbington-Smith Committee, D.M.Dalal, and among the witnesses who appeared before it, Manusubedar, V.Thackeray and B.F.Madan, represented this tendency. In 1926, Purushottamdas Thakurdas and his small group of advisers claimed this mantle. It is hard to prove the view held by the India Office that these nationalists were consumed by a gold fetish. It has been recognized that the nationalist demand for a gold standard reflected the

15 PRO T176/25B, Blackett to Niemeyer, letter dated 3 December 1925. IOLR V/26/302/8, Qns.539-543.

16 IOLR V/26/302/8, Qns.1383 and Qn.435.

17 IOLR V/26/302/8, Qns.10005-10007.

contemporary desire for an automatically regulating currency system that could not be subject to political manipulation.[18] But the concern of the "nationalist" business interests at India's own appetite for non-monetary gold has passed without comment.

In 1919, many Indian witnesses and Dalal himself in his minority report, blamed London for choosing to liquidate India's war-time surpluses in the form of silver rather than gold or gold-backed securities. The model of an Indian economy they seemed to have in mind was that of an open economy in which gold or security flows balanced India's external accounts, much as they did at the centre. They saw the transfer of the Gold Standard Reserve to India as providing the basis for the working of the above model. It would also assist the emergence of a banking system which was capable of mobilizing India's potentially huge savings and managing the liquidity position of the domestic economy in a way as not to impose a brake on trade and business activity.

The Bombay industrialists including Thakurdas were not happy with India's large gold imports in the two years preceding the setting up of the Hilton-Young Commission.[19] Thakurdas agreed with Pherozeshah Dalal that the unprecedented gold imports affected consumption of cotton piece-goods, both foreign and indigenous, and diverted funds away from productive investment. He blamed the currency policy of the government for causing increased gold imports and hoarding, as no importer would sell his gold to the mint at the 2s. statutory rate.[20] He also argued that large non-monetary gold imports made monetary conditions tighter rather than easier. The Bombay Mill Owners Association passed a resolution to the

[18] See Tomlinson, **Political Economy**, 1979, p.68, and De Cecco, **Money and Empire**, 1984, p.71, pp.74-75.

[19] See for instance the tenor of Thakurdas's questioning of Blackett in IOLR V/26/302/8, Qns.10395-10414.

[20] NMMA PT Papers, File 47, Part 1, P.Dalal to Thakurdas, letter dated 18 February 1925 and the latter's reply dated 22 February 1925.

same effect.[21]

Thakurdas believed that gold hoarding had begun with the demonetization of the gold rupee over 1830-1835 and a re-monetization would bring gold out of the hoards. But Strakosch, his colleague on the Hilton-Young Commission, disagreed. He suggested to Joseph Kitchin - a gold dealer who appeared before the commission - that if gold came out of hoards to circulate as money, they would only replace other forms of currency and not alter the overall picture on metallic flows. Kitchin agreed.[22]

It is easy to see that Strakosch's arguments were wrong and contradictory. The liquidation of Indian gold hoards would have had the same effect as the liquidation of any other non-monetary asset. The proceeds of the liquidation would be invested in more liquid assets and gold so released would be a net addition to the world's monetary gold reserves. At the very least, if gold came out of hoards to circulate as money, they would replace a portion of India's monetary gold imports, over which such fears existed in Europe.

The India Office did not believe that a gold standard would reduce Indian gold demand in the long-run, let alone that it would increase world gold availability. On the contrary, it was feared that it would only worsen the problem. Opinion in London was also convinced that, in estimating India's future demand for gold under a gold standard, the possible liquidation of her private hoards need not be taken into account.

Hence, the India Office and the Treasury were not inclined to take the threat

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[21] NMMA PT Papers, File 47, Part 1, Thakurdas' letter to the **Times of India** dated 27 May 1925 and BMOA resolution on page 63 of the file.

[22] IOLR V/26/302/8, Qns.13482, 13523 and 13600.

contained in the Indian proposals, lightly. We saw earlier that, soon after reaching Bombay, E.Hilton-Young alerted Prime Minister Baldwin to the effects on London of the gold standard scheme. Kisch at the India Office, on learning of the scheme, wrote that it did not take into account "disturbances" that would be caused to "interests the world over".[23] The India Office also began mobilizing London opinion. In a letter to Niemeyer, Kisch referred to the gold standard memorandum and said, "in view of the important bearing that the scheme has on the position and prospects of gold and sterling", the gold standard papers were being sent to him for his "private information". The papers also included Kisch's own notes on the subject, argued as he did not omit to point out, from "the point of view of the interests of India." He assured the Treasury official that upon its return, the currency commission would take evidence from the India Office and "other representatives of opinion in London."[24]

Meanwhile Blackett had been in touch with Niemeyer at the Treasury. Niemeyer's first response was to note on Blackett's letter that "Simla (had) got hydrophobia from Bombay."[25] In his reply, he said that the scheme filled him with "pity and fear". He did not see any advantage to India to bear 100 million pounds of "America's burden, at the cost of disturbing the currencies of most of the civilized world (including continental countries now stabilizing ...) and also annihilating the silver market." It was bound to endanger the gold standard, indeed "to end (it) altogether." He expected "very strong opposition from all financial circles in this country at least." A gold standard and a gold coin would not change the

23 IOLR L/F/7/2283, Colln.375, F.12, letter to Baxter dated 10 December 1925. Baxter was travelling with the Hilton-Young Commission as one of its two secretaries.

24 IOLR L/F/72278, Colln.375, F.7, Kisch to Niemeyer, letter dated 23 January 1926. In an internal India Office memorandum, Kisch noted that it was impossible to "exaggerate the importance of the matter and though one may hope that the Commission may kill the scheme, there (was) always the risk that they may be overborne by the pressure of non-official opinion in India ...."

25 PRO T176/25B, Niemeyer's note on Blackett's letter dated 3 December 1925.

"immemorial habits of the East on savings and investment", Niemeyer said, and hoped that Blackett would have difficulty in convincing Strakosch and the other members.[26] On receiving this letter, Blackett complained about its tone to Strakosch, who relayed the complaint to Niemeyer. In a draft of a letter that was probably not sent, Niemeyer reiterated his disagreement with Blackett's "volte-face to gold in circulation" and said he failed to understand Blackett's resentment. "You must not forget, sitting in Simla, that I have politicians too."[27]

One of the more important politicians in question was Winston Churchill, Niemeyer's Chancellor of the Exchequer. About this time, attacks directed against the costs of the lines of credit (involving the Bank of England, the New York Federal Reserve, the Treasury and the Morgans) established to assist the sterling's return to the gold standard, resumed in the press and the House of Commons. Stung by the criticisms, Churchill, always a reluctant advocate of the restoration, asked Niemeyer if it was necessary to persist with the Treasury's arrangements with the Morgans. "Pray ... do not let us drift into paying unnecessary fees", he noted.[28] Niemeyer replied that it was too early to terminate the line of credit. A "disturbing element which is at present unknown to us, will be the report of the Commission now sitting on Indian currency. If their report involved a considerable withdrawal of gold, it would be imprudent to deprive ourselves of any existing protection." Other uncertainties were the overseas lending position (which the Treasury was keen to regulate) and coal.[29]

Perhaps as Niemeyer expected, Churchill was moved by the above note to action.

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[26] CCA Hawtrey Papers, Htry 1/3/2, Niemeyer to Blackett, copy of letter dated 22 December 1925.

[27] PRO T176/25B, Niemeyer to Blackett, draft of letter dated 2 February 1926.

[28] PRO T172/1500A, Churchill to Niemeyer, note dated 10 February 1926.

[29] PRO T172/1500A, Niemeyer to Churchill, letter dated 10 February 1926.

"Tell me more about the Commission on Indian currency", he minuted, " ... I did not understand that any danger would come from this quarter. It would be important to discuss any evil development with Lord Birkenhead at an early stage." Niemeyer replied that if the gold standard proposals were accepted, India might try to take gold from London. "I dont think the C(ommissio)n. will support the scheme : and the India Office are opposed to it and well aware of the difficulties. I think overt action by us ... would be unjudicious vis-a-vis Indian opinion." Churchill agreed there was no question of overt action but "only of guiding events at an early stage by private representation." He sought a short note on "what we do not want to happen and why."[30]

Niemeyer's note was along the expected lines. After briefly speaking of "Indian interests", he went on to discuss the question from a more general point of view. He said a gold loan necessitated by the Indian gold standard scheme would be "unwelcome" to Britain. The appreciation of gold that might result would have serious repercussions on the "gold currency systems of the world, in particular our own ...." The proposal to sell silver would upset the silver countries and lead to an increase in the prices of lead and copper "which most of Europe has to import from America." He continued, "I believe the Currency Committee(sic) are fully aware of the dangers of the Indian scheme, and will, in fact, fight them in their recommendations ..." but, "their task has not been made easy by the mobilization of Indian opinion and the forthcoming attitude of official representatives in India." Niemeyer enclosed a draft letter to the Secretary of State for India which warned him of the consequences of the Indian scheme though the reasons in this letter were couched in Indian terms.[31]

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[30] PRO T176/25B, Note dated 11 February 1926.

[31] PRO T176/25B, Niemeyer's note dated 17 February 1926; IOLR L/PO/2/3(i), Churchill to Birkenhead, "personal and secret" letter dated 22 February 1926. Note Niemeyer's confidence that the currency commission would "fight" the Indian scheme. These views were expressed before it began taking evidence in London and

In his reply, Birkenhead said the gold currency proposal would not be accepted light-heartedly "even if it were supported by the Royal Commission" and suggested that the Treasury send a witness to put its case. "... I am quite ready if you wish to suggest privately to Hilton-Young that this should be done."[32]

On the suggestion that a Treasury official appear before the commission, Niemeyer's note bears detailed quotation. "I had already discussed this with Mr.Hilton-Young and ... both of us thought it undesirable for Treasury to give evidence. We dont want the rejection of Indian ideas to be attributed to the British Treasury as this may raise real trouble in India." The commission would hear the Governor of the Bank of England and others "who will be quite sufficient. I think it would be bad tactics for the Treasury to assume, at this stage, the burden of direct opposition and much better to keep ourselves in reserve .... I am ... in close personal touch with several members ... and I believe we can be more effective in this way than by a frontal attack - at any rate until we are forced (which I dont think we shall be) ... into such an operation." Churchill scribbled "Yes" on the note.[33]

It was not only opinion in London that was being mobilized to defeat the Indian government scheme. Across the Atlantic, Benjamin Strong found Montagu Norman "appealing" to him "for help to defeat the ... proposal". Initially reluctant to intervene in, what he saw as, a "semi-political question between Great Britain and one of her dominions(sic)", the "worldwide concern" that the matter aroused,

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reflected a perception of interests ranged against the proposal and knowledge of the private views of its principal members.

[32] IOLR L/PO/2/3(i), Birkenhead to Churchill, letter dated 24 February 1926. Birkenhead also conveyed Churchill's views to the Government of India. See IOLR L/PO/2/3(i), private letter to the Viceroy dated 25 February 1926.

[33] PRO T175/25B, Niemeyer's note dated 26 February 1926 on Birkenhead's letter and Churchill's marginal note of 28 February 1926.

however, finally persuaded Strong - according to his biographer - to respond to Norman's plea. Strong was also encouraged by Andrew Mellon, the US Treasury Secretary to meet the Hilton-Young Commission and convey American opposition.[34]

Meanwhile, consultations were going on within the Bank of England. Officials at the Bank were also talking to important members of the commission and to officials at the India Office. For example, Charles Addis, who, on this occasion, represented the Bank of England (jointly with Montagu Norman), noted in his diary that, together with Norman, he met with Strakosch at his house "and had a great pow-wow on gold for India for 2 hours."[35]

With the interests opposing a gold standard in India mobilizing in concert, the outcome of the commission's deliberations on this question was probably in the nature of a foregone conclusion.[36]

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[34] L.V.Chandler, **Benjamin Strong,** 1958, pp.356-359 and p.254. Mellon's chief concern was silver.

[35] SOAS Addis Papers, Pp.Ms.14/44, Diary entries of 15 February 1926 and 5 March 1926. The February entry noted that Addis had called at the India Office to discuss the Indian gold standard.

[36] There is a noticeable contrast between Treasury mobilization in 1919 and in 1926. In the former case, though the India Office was quite sensitive to the problem of gold for India and the Bank of England also expressed strong reservations, it was left mainly to Charles Addis on the committee to emphasize the "general" aspects of the Indian gold demand. There is no evidence of Treasury mobilization at the committee stage. When the Treasury did move, on the eve of the report's publication, it was forced merely to seek an indefinite delay in implementing those parts of the report that might have increased gold movements into India. Although successful, the nature of intervention suggests that, in 1919/20 the Treasury expected the sterling's return to gold to be easier than it was in reality and that they were perhaps more sanguine about the threats posed to the sterling and the position of London as a financial centre by the countries of the Empire. The Treasury in 1926, in contrast, betrayed a gloomier outlook for the sterling and the gold standard. Certainly, the travails of the sterling and the British economy in the intervening years, and the circumstances in which the sterling was virtually hustled on to gold might have justified the gloom. Also, the reduced dependability of the Dominions in monetary matters (for example the behaviour of South Africa and Australia in 1924 and 1925) may have persuaded the Treasury of the advantages of an early move to restrict the freedom for manoeuvre of another colony which was on the verge of stabilizing. How far its experiences with South Africa and Australia educated the Treasury and contributed to its

Nevertheless a brief survey - even as we avoid rehearsing all the individual arguments - is in order.

The main objections to the gold standard proposals centred around two points: the increased Indian gold demands that might arise and secondly, the effects on the silver markets of a possible reduction in India's holdings of the metal (both official and private), were the gold standard proposals to be implemented. They were linked in that, larger the silver released from monetary circulation and hoards, **ceteris paribus**, greater the gold that would be required to replace them and, (assuming that gold dis-hoarding in India was not promoted by the monetization of gold) lower the price of silver in relation to that of gold, and greater the size of the gold loan that may be required to launch a gold standard in India. The designers of the Government of India scheme estimated that in order to have an effective gold standard in place, India's gold requirements would be of the order of 103 million pounds.[37] They realized that a gold demand of this magnitude might upset the world's markets. Only the crucial nature of the proposals, from the Indian point of view, justified the risk. The deflationary risks of the proposal and the threat it posed to the gold standard elsewhere could be averted by a careful management of the transaction and collaboration between the government in Delhi with British and US governments (as the 1918-19 silver transfers had been managed) and between the London and New York money markets.[38] The Indian government also hoped to tap the gold sterilized by the US Treasury and the American Federal Reserve System.[39]

determination to resist an advance towards monetary autonomy in India is also a point worth considering.

[37] IOLR V/26/302/6, Denning's memorandum, "Gold Standard for India", and IOLR V/26/302/8, Qns.1514-1523.

[38] IOLR V/26/302/8, Qns.534-37, 10234-35 and 10244; IOLR Mss.Eur.E397/32, Blackett to Strong, letter dated 21 December 1927 and PRO T176/25B, Blackett to Strakosch, letter dated 11 October 1925.

[39] IOLR V/26/302/8, Qn.1523.

Treasury and London opinion generally were much less sanguine although there was no unanimity here. Hawtrey drew up a memorandum for the Treasury on the relationship between Germany going on gold in 1871 and the Great Depression that followed. "Germany at a stroke decided to substitute a large quantity of gold for silver.... The shock was too great ... for the bi-metallic countries ...and the stampede to gold that followed brought about the fall in the world price level and the collapse of the silver market."[40] In another memorandum, Hawtrey said that if India demanded more gold than the "enormous" amounts she already imported, "there will be nothing left for the rest of the world out of new production from the mines for years to come." India, he said, could force the world to relive the experience of fifty years previously. He also drew attention to the effects on silver of India's off-loading of the metal. Finally, Hawtrey warned of the threat of increased bank rates in London, should India have her way. The demands from India for gold will fall "in the first instance on London" because India would liquidate her sterling reserves to buy gold and her gold demands "can only be met from American gold reserves in so far as England can draw on these latter."[41]

The Bank of England witnesses to the Hilton-Young Commission, Montagu Norman and Charles Addis, echoed these reservations. A few months previously, Norman had cited supposedly excessive gold imports by India as a reason for not lowering the bank rate despite an influx of gold and a fall in prices.[42] He had earlier given up hopes for gold circulation in Britain because of the threats posed by "such unknown quantities as India and Russia". In order to hasten Britain's return to

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[40] CCA Hawtrey Papers, Htry 1/3/2, "The German Gold Standard and the Value of Gold after 1871", memorandum dated 17 February 1926.

[41] CCA Htry 1/3/2, "A Gold Currency for India", memorandum by Hawtrey written in February 1926.

[42] PRO T176/13, Part 2, Niemeyer to Norman letter dated 21 July 1925 and Norman's reply dated 24 July 1925.

gold, he wanted her to establish a "gold bullion standard" in which gold was available only in large units to settle international imbalances.[43] The Governor and Addis reiterated that if India went on gold, European stabilization, which was already delayed, would be seriously hindered. Some gold backing was necessary to strengthen their credit structure, but already the bulk of the surplus gold was going to India. If India demanded more gold, interest rates and costs of production would increase. The volume of international trade would be restricted and the real burden of foreign indebtedness increased.[44] The Bank of England, they said, would be particularly affected. Its reserve position would be eroded, necessitating a rise in the bank rate.[45] For these reasons, Norman and Addis added, it would be extremely difficult for India to raise loans for the scheme.[46]

The sizeable American banking representation was also unequivocal in opposition. George Roberts, a Vice-President of the National City Bank of New York said that a gold standard for India would retard the restoration of the gold standard elsewhere. He argued that Indian gold demands already posed the greatest threat to the gold standard, though he added in the same breath that America did not possess any more gold than she needed to back her currency. The New York Federal Reserve delegation also expressed opposition to the Indian scheme. In his statement, Benjamin Strong said the Indian monetary programme was a "vital" American concern. Apart from domestic interests, it also affected USA's international monetary relations and her role in their reconstruction. An Indian gold standard would be an "unsustainable" burden on the reserves of the central

[43] See Henry Clay, **Lord Norman**, 1957, pp.153-54.

[44] IOLR V/26/302/8, Qns.13668-72 and 13679-85. Note the real variables inflexibility assumption implicit here which contrasts with the smoothness of adjustment postulated in the Indian case.

[45] IOLR V/26/302/8, Qns.13666-67.

[46] IOLR V/26/302/8, Qns.13740-44.

banks.[47] Dr.Hollander who was a member of the Strong delegation also drew parallels with Germany's adoption of the gold standard in the 1870s and said the Indian plan would, besides disrupting monetary restoration everywhere, lead to "higher interest rates, business disturbances and economic depression."[48] The American delegation suggested that India adopt a gold exchange standard operating not only through London and the sterling but also through New York and the dollar.[49]

An associated question was the consequences of an Indian gold standard for the silver market. The parallels were again historical. As the European continent left silver for gold in the 1870s, silver prices began to fall. This hastened the movement by other countries towards gold. Although India too left silver in 1893, its currency system was not immune to the vagaries of the silver market because of the prevalence of token silver rupees and the guaranteed convertibility into them, of paper notes. As we have seen, this was one justification for Blackett's gold standard scheme.[50]

Although the consequences for the rupee of disturbances in the silver market were bound to be severe, the effects of an Indian gold standard on the silver market were not to be dismissed lightly. The impact on silver currencies of large Indian sales, notably the effect on China, was feared. Kisch raised the spectre of lower Chinese imports and possible political problems with China.[51] Charles Addis said that Britain's trade with China was currently "small" but it was the "one great

[47] IOLR V/26/302/8, Qn.15229.

[48] IOLR V/26/302/8, Qn.15232.

[49] IOLR V/26/302/8, Qn.15311, part iv.

[50] IOLR V/26/302/8, Qn.10005-10007.

[51] IOLR V/26/302/8, Qn.10815.

market" left for the expansion of British industry. An Indian gold standard would damage the development of this market, he claimed.[52] It was also feared that if China was forced to go on gold through the bandwagon effect (as it was said to have driven the USA in the last century), the upset for the gold countries could be even greater.[53]

According to a report submitted by Benjamin Strong's delegation, if India went on gold, silver prices would fall by half and India would find it difficult to sell her silver at a price high enough to buy sufficient quantities of gold. Indian silver-holders would lose and the silver mining industry in USA, Mexico and Canada would earn "greatly reduced" profits. Copper and lead prices would increase greatly.[54]

Much of the rest of the evidence echoed these projections. Norman and Addis talked of silver being "dethroned". Given the US interest in silver, there was a political problem as well. Silver had a "large ... political backing" there and any controversy might make borrowing in USA difficult. Even raising a loan in London, Norman said, in an interesting public admission of London's dependence on US goodwill to stay on the gold standard without further deflation, will raise tricky problems between "us here and our friends in America" and perhaps, even between the two governments.[55]

It is easy to understand the American interest in protecting the value of silver. It

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[52] IOLR V/26/302/8, Qn.13710.

[53] See the discussions between Keynes and Strakosch in IOLR V/26/302/8, Qns.13108-23.

[54] IOLR V/26/302/8, Qn.15238, "Summary of Reports submitted by Mr.Arthur Notman and Captain H.A.C.Jenison", section xvii.

[55] IOLR V/26/302/8, Qn.13740. Dr.Hollander, a member of the Strong delegation told the commission (Qn.15232) that the damage to US silver interests who represented a "great American industry" would raise an outcry so loud that, it might even lead to "an outright prohibition" on all foreign loan flotations in the USA.

is much less easy to understand Britain's motives in defending silver at this time, especially in the light of her actions in the 1930s which were aimed at keeping silver prices low, unless we postulate that the main British concern was not the silver market **per se** but the effects on the market for gold, her own gold standard and the American willingness to lend abroad.

The silver issue was a tricky one even without Britain's interests coming into conflict with those of the USA or of India. As Keynes admitted, India's experiences with silver had been "unfortunate". The metal had "few natural supports" and regardless of any Indian move, its position was "precarious".[56] India was, in effect, in the position of a large holder of an inferior security. She could not hold it without suffering large capital losses, nor could she hope to sell, except very gradually as the market allowed and even then, sustain heavy losses.[57] There were doubts also about the actual size of Indian silver sales and her gold demands. While the Denning memorandum estimated a 103 million pounds gold requirement, the India Office estimated that India would off-load 700 million ounces of silver. The exchange bankers, including one who sat on the commission, thought this to be an over-estimate. W.Preston suggested that with a silver rupee circulation of Rs.2500 million and a per-capita silver rupee requirement of Rs.6, only Rs.800 million was left to be sold in the market or converted into gold. Of this Rs.400 million was

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[56] IOLR V/26/302/8, Qns.13149 and 13045 respectively.

[57] The Indian experience with silver was notable also because a large part of its holdings of the metal had been bought at artificially high prices when the world's demands for India's exports were pressing and importers would have gone to great lengths to procure the necessary first class financing. Kisch regarded Indian silver sales as an act of "ill-grace" towards America which had striven to "benefit" India through the Pitman Agreement; see IOLR V/26/302/8, Qn.10815. But more detached accounts suggest that American profits and Indian losses on the unfinished part of the deal covered by UK's debt to the USA in 1933 was, owing to the fall in silver prices, 66 million ounces; see PRO T160/8, F260/3, "Pitman Silver", Bowley's memorandum dated February 1933. It is also useful to contrast India Office opposition to Indian silver sales in 1926 on the grounds that they would destroy the silver market with its insistence four years later that India should not stop selling silver merely because it lowered silver prices. This is briefly discussed in the next chapter.

needed as a "fair reserve" for the Government of India, while the remainder would be accounted for in about five years by an annual estimated rupee absorption of Rs.90 million.[58] On a similar basis, B.F.Madan, who informally advised Thakurdas on currency matters, disputed the need to sell silver and the "absurd proposal for a gold loan".[59] The worst case assumptions projected by the India Office also did not consider that, as silver prices fell in relation to that of gold, the Indian asset-holder would have been tempted to move out of gold and into silver (as he had moved traditionally between the two metals and as he was to do in the 1930s), thereby retarding the tendency for silver prices to fall.

In the event, the Hilton-Young Commission proceeded to assume the worst and turned down the gold standard demand because it would be ruinous for silver.[60] However the expressed concern for silver was not sufficient to prevent the commission from recommending a "gold bullion standard" in which the silver rupee would be de-monetized and silver reserves phased out.[61] Between 1927 and 1930, 90 million ounces of silver were sold by the Government of India from its reserves.[62] As we see in the next chapter, the behaviour of the British authorities on silver after 1926 did not conform to their earlier concern for its prices and for the holders of the metal.

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[58] See Preston's questioning of Norman and Addis in IOLR V/26/302/8, Qns.13764-779.

[59] NMMA PT Papers, File 58, Madan to Majumdar, letter dated 26 March 1926. Madan cited the American system, in which a silver dollar circulated under the gold standard, as a model for India.

[60] IOLR V/26/302/6, **Report of the Commissioners** (hereafter the **Report**), paras.46-50; PRO T176/25B, note by J.Kershaw of the Bank of England, "The Indian Currency Commission Report as Affecting Silver", dated 12 October 1926. Kershaw pointed out that US evidence was valuable in defeating the Indian proposals.

[61] IOLR V/26/302/6, **Report**, paras.69-71.

[62] PRO T160/547/F32420/1, US Congress, February 1931, "Interim Report and Recommendations of the Committee of the Foreign Relations Committee on Trade Relations with China and Causes and Remedies for Depressed Conditions for Commerce". The committee was set up by the US senate and headed by Sen.Pitman.

It is hard therefore to accept the view that, except in so far as it complicated economic and political relations between Britain and the United States at a time when Britain was in need of American goodwill, the effects of the "dethronement" of silver (as Montagu Norman chose to call it) played a major role in the rejection of the Indian gold standard proposals. The crucial fear was the effect of the latter on the gold market.

Despite Britain's return to gold and the relatively easy outlook for it in the early months, the sterling was not quite out of the woods. Britain was still looking to America to keep its discount rates low. On the other hand, the USA itself was determined to ensure that she did not have to bear the costs of an European recovery even as American bankers, among others, were tempted by opportunities in Europe. As a result, America's ability to contribute - despite the size of its gold holdings much of which were sterilized - to European recovery was limited. An Indian gold loan would have diverted liquidity from Europe and, besides threatening the British gold standard, it would have also damaged British aspirations to bring the European countries under the monetary influence of London through a sterling-based gold exchange standard.

The rejection of the Indian gold standard proposals did not, therefore, come as a surprise to either Indian or London opinion. The **Times** on its City page had anticipated the conclusions of the report in regard to the exchange rate and the currency system, well before the commission began its sittings.[63] The Indian Merchant Chamber saw that Britain's ability to stay on gold depended "very largely on the action which India is made to take or refrain from taking." Kisch at the

[63] The **Times** dated 22 September 1925.

India Office thought this reflected "perhaps a little pardonable egotism".[64] But the Indian Merchants' views were shared by authoritative sources in London. The Annual Montagu Bullion letter for 1924 said that the Indian exchange was "almost as important (to the UK) as to India itself" and more the gold India takes, greater would be the delay in England's return to gold.

Also, the presence of members like Strakosch had already seemed to some observers to indicate that the Indian currency proposals would not get a sympathetic hearing.[65] Neither Strakosch nor even Hilton-Young to a certain extent, made efforts to conceal their hostility to the Indian gold standard proposals or their sympathy for the metropolitan view. The former's combative handling of witnesses who either supported a gold standard (Prof.T.E.Gregory) or who were indifferent to its consequences for the price of gold (J.Bradbury and J.M.Keynes) was in sharp contrast to his handling of witnesses who were opposed to a gold standard for India. The nature of the questions asked, the elaborations sought and the assumptions that lay behind them revealed the biases of the more important members of the commission.[66]

In the event, the Hilton-Young Commission recommended a "gold bullion standard"

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[64] IOLR L/F/6/1076, F.2588, Indian Merchants' Chamber to the Finance Department of the Government of India, letter dated 21 May 1925.

[65] See **Capital** dated 26 November 1925, p.1167 quoting a pamphlet by a Prof.Jumbarkar of Dacca University.

[66] IOLRV/26/302/8,Qns.12786,12788;Qns.14210,14245-249,14272and14311; Qns.13108-13123. Hilton-Young prepared a memorandum entitled "A Gold Standard for the Currency of India" as a "starting point" for a resolution of the question. In this memorandum he attacked the Indian gold standard proposals from the "general" rather than the local standpoint. A copy of the undated memorandum was sent to Niemeyer at the Treasury. It is filed in PRO T176/25B. The Transvaal Chamber of Mines also expected that the Treasury would oppose a gold standard for India because it feared an appreciation in the price of gold. Enclosing a typescript of this report, Pherozeshah Dalal told Thakurdas that it was "evidence in advance" of British intentions. NMMA PT Papers, File 55, P.M.Dalal to P.Thakurdas, letter dated 4 January 1926.

involving, on paper, the purchase and sale of gold (the latter for export purposes only) by the Government of India in units of 400 ounces or more. Tomlinson has argued that, owing to the ignorance of Delhi officials, in practice, this system worked as a sterling standard.[67] But as we show later, right from the beginning, London officials had no illusions about the system and they expected it to operate as a sterling standard. Indeed, that was the intention behind the scheme. The discussions surrounding the so-called gold bullion standard also reveal just how keen British officials were to ensure that Indian trade was not financed by gold movements, but, instead, by purchases of sterling.

As early as 1913, Keynes had argued that if it became necessary to shift the gold standard reserves to India, it should be ensured that, in a crisis, gold was sold only to the banks and not to the public. Only in the former case, he said (wrongly, as we know from the 1920 experience), could reserves be used to support the exchange.[68] Blackett's proposals that gold bullion should be issued for export against rupees echoed Keynes' reservations. But Hawtrey objected even to the presence of a gold reserve in India. Indian reserves, he felt, were better held in the form of sterling. If you give the "holder of rupees the right to demand gold ... at once the sterling reserve becomes inferior in utility ...." Further, if Indian authorities were required by law to buy gold, it might be possible to obtain rupees on better terms by sending gold from Durban than by offering sterling. Unless gold was bought in transit and diverted to London, the whole of the additional rupees required for circulation would be issued against gold received in India, which would thus finance a larger part of Indian trade than under an exchange standard. The requirement to sell gold might mean that, in some cases, it could be cheaper to send gold from India to China or Europe at the gold export point than to buy

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[67] Tomlinson, **Political Economy**, 1979, p.78.

[68] **JMK**, Vol.1, p.124.

sterling.[69] The "gold policy of India", he said, "ought to be carefully related to the Genoa Resolutions. Whatever gold it is willing to take as a share of the general burden of the world's banking systems, it should buy from South Africa or the United States, but the amount should be agreed, so that the gold using countries of Europe and America may know how they stand."[70]

The opposition of the India Office bureaucracy to a direct link between the rupee and gold is evident from Kisch's testimony to the currency inquiry. To begin with, Kisch refused to admit that there was any difference between a sterling exchange standard and a gold exchange standard. He also said that it was open to question what form the Indian government's obligation to convert rupees should take.[71] He objected to expressing the rupee in terms of gold ostensibly because the price of gold would have had to include transport and insurance which might vary. He suggested that the Government of India should sell exchange at par rather than gold.[72]

After Kisch had exposed the anti-gold predilections of the India Office so blatantly, there was some backtracking and here again, as at the time of the Babbington-Smith Committee, Brunyate played the leading part in organising the retreat. Recently retired from official positions at the India Office but still in close touch with individual members of its bureaucracy, Brunyate supported the idea of

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69 CCA Hawtrey Papers, Htry 1/3/2, letter to Blackett dated 16 October 1988. For Blackett's response to Hawtrey, see his letter to Strakosch dated 17 October 1988 in PRO T176/25B. He said Hawtrey did not understand the political side to the gold question in India. Moreover, after sterling's recent experience, he said, it could hardly be claimed that it was synonymous with gold.

70 CCA Hawtrey Papers, Htry 1/3/2, "Indian Currency", memorandum dated 28 August 1925.

71 IOLR V/26/302/8, Qns.11267, 11270.

72 IOLR V/26/302/8, Qns.11271-11280.

expressing the rupee in the form of gold.[73] Kisch, who resumed his interrupted testimony immediately after Brunyate, clarified, after such a clarification was sought by Reginald Mant probably by previous arrangement, that the rupee would be "anchored" to gold and equivalent foreign exchange. On being requested, he produced a draft clause which suggested that the rupee be fixed at "x" grains of fine gold.[74]

Having on the face of it lost the battle to fix the rupee to sterling rather than gold, the India Office proceeded to frustrate a gold-bullion standard for India by other means. Kisch suggested a premium on gold sales by the Government, i.e., effectively a discount on the rupee. Though such a discount, he conceded, was "illogical", it was nevertheless of great practical convenience to prevent demand for social purposes of gold from the Government of India.[75] With the realisation that it would be impossible, for political reasons, to deny India some form of a "gold bullion standard", Strakosch and officials at the India Office set about fixing the buying and selling prices of gold in India in a way as to prevent gold going to India for trade purposes even in the new system.

The commission's gold price formula was an outcome of this effort. As Strakosch wrote to Mant, according to this formula, the rupee would have to be "**above** 1s.6 $^{1}/_{16}$d." at least, for India to get South African gold. If the shipper of the gold secured forward cover, the cost of the cover would have to be added to the gold import point. Therefore, it would not be profitable to ship gold to India unless the rupee was above 1s.6 $^{5}/_{32}$d. in the market. This, according to Strakosch, compared favourably with the Bank of England's gold price of 77/101/2d. per standard ounce

[73] IOLR V/26/302/8, Qn.11303.

[74] IOLR V/26/302/8, Qns.11483-486.

[75] IOLR V/26/302/8, Qn.11657.

and shipped to Bombay at 18 $^{13}/_{64}$d.[76] A copy of this letter was sent to Niemeyer who noted on the covering letter that whether "gold can be so shipped (or not) ... a gold standard bank ... can't refuse to buy gold and if it doesn't want to do so, must so control its exchange that it doesn't have to!"[77] It was probably a coincidence that the highest level that the rupee reached in the five years till sterling went off gold was well short of the notional gold import point. But Blackett clearly wished that the rupee should not rise to that level. As he wrote to Strong at the end of a somewhat boastful account of how he had managed to stabilize the rupee, "... it is not impossible that import gold point may be reached in a month or so, which I don't much want but may be unable to prevent ...."[78]

Hawtrey, though he was inclined to think that the gold import point was closer to 18 $^{7}/_{32}$d. than to $^{5}/_{32}$d., was more pessimistic about the long-run impact of an Indian gold bullion standard on British gold receipts from South Africa.[79] He was particularly concerned that as traffic patterns changed, the Durban-Bombay freight for gold, which was currently higher than that for the longer and faster Durban-London voyage, would fall.[80]

On the whole however, London was less inclined to worry. The Cabinet memorandum on the commission's report said the provision for gold sales in India

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[76] PRO T175/25B, Strakosch to Mant, letter dated 15 November 1926; emphasis in the original. The commission fixed a gold selling price in India of Rs.21-11as.-9p.per **tola**. See IOLR L/F/6/1099, F.5803, Kisch to Brayne, letter dated 22 November 1926. Kisch said, at this price, the demand for gold from the monetary authorities for social purposes would be eliminated.

[77] PRO T175/25B, Strakosch to Niemeyer, letter dated 16 November 1926.

[78] See IOLR Mss.Eur.E397/32, Blackett to Strong, letter dated 21 December 1927.

[79] CCA Hawtrey Papers, Htry 1/3/2, Hawtrey's memorandum, "The Indian Currency Report", undated but probably written in November 1926.

[80] CCA Hawtrey Papers, Htry 1/3/2, Hawtrey's note dated 18 November 1926 on Strakosch's note on Indian gold import and export points of the same date.

was "... a concession to Indian sentiment ...." and was not an essential aspect of the system. The large difference between the buying and selling prices of gold in India meant that bullion could be obtained from the currency authority, only "at ... a disadvantageous price ...." Therefore, "... the proposals of the Commission will (not) involve any increased demand by the Indian public for gold." The gold reserves required for the new system, the note said, would be acquired gradually. It affirmed that rather than gold, in practice, only sterling would be bought and sold.[81] The Treasury also expressed satisfaction at the commission's rejection of the gold standard proper to which we "took objection".[82]

The Treasury was not alone in supposing that in its actual working, the gold bullion standard would behave really as a sterling exchange standard. Despite the commission's explicit rejection of the latter, within weeks of the report's submission, the India Office had decided that the gold bullion standard need be no different from a sterling exchange standard.[83] Kisch also wrote to a member of the India Office Finance Committee that the "complicated gold bullion standard which the Commission proposes" was "largely a make-believe affairs"(sic). J.Brunyate and Charles Addis were among the others who expected that the Indian gold bullion standard would work merely as a sterling standard.[84] Later in 1932, when the USA

[81] PRO T172/1375, Cabinet Memorandum C.P.288(26) of July 1926.

[82] PRO T172/1375, Niemeyer's note to Chancellor of the Exchequer dated 29 July 1926.

[83] IOLR L/F/7/2286, Colln.375, F.15, Kisch's "Review of Report of Currency Commission" dated early July 1926.

[84] IOLR L/F/7/2287, F.16 of Colln. 375, Kisch to Goodenough, letter dated 15 September 1926; SOAS Addis Papers, PP.Ms.14/557, Draft Reply to J.B.Brunyate dated 12 November 1926 expressed agreement with the latter that the gold bullion standard was unlikely to be "operated in practice". It is noteworthy that Brunyate who had earlier seemed to support the idea of linking the rupee to gold rather than through sterling should later hold this view about the inoperability of the gold bullion standard. One explanation for the apparent contradiction may really relate to the habits of the civil servant. He may have chosen to go along with a clamour of the moment (i.e. some sort of a gold standard for India) while hoping to frustrate its implementation at a later stage. This may also help explain the change

blamed the decline in the fortunes of silver and the depression generally on India having gone on gold in 1927, the India Office maintained that India had always stayed on a sterling standard. It wanted the Treasury to make this point explicitly in its communications with the USA.[85] Nevertheless, the India Office continued to maintain, in public, the fiction of an Indian gold bullion standard till the events of September 1931 stripped it of whatever plausibility it possessed.

In contrast, the Indian government thought initially that the new scheme was a step towards a full-fledged gold standard and presented it in India in this light. Delhi attempted, when the legislation was being enacted, to include a provision to coin gold **mohurs** in India. The India Office rejected the move as a back-door method of securing a gold standard and explicitly ruled out a gold coin and a future gold standard for India. The Government of India complained that it had been under the wrong impression regarding the true purport of the Hilton-Young Commission's recommendations which they would be guilty of having promoted in India under false pretences![86]

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in the tenor of Kisch's testimony after Brunyate expressed himself in favour of a link between the rupee and gold.

In his notes for a speech as Chairman of the Hongkong and Shanghai bank, Charles Addis went further than Brunyate and said (PP.Ms.14/558, "Notes for a Chairman's speech", December 1926) the gold bullion standard was "intended to be inoperative". It bears noting that Addis had been involved in a "great pow-wow on gold for India" with Norman and Strakosch when the commission moved to London after taking evidence in India.

[85] PRO T160/547/F3420/3, Baxter to Waley, letter dated 18 April 1932 and T160/488/F13017/04, draft financial memorandum, "Some Aspects of the Silver Question" prepared jointly by Treasury and India Office for the World Monetary and Economic Conference of 1933, para 6(iv). Appendix B to this memorandum was on "The Position of Silver in Relation to the Indian Currency System".

[86] See the correspondence in IOLR Mss.Eur.D703/27.

V.3 THE EXCHANGE RATE QUESTION

The second controversial question before the Hilton-Young Commission was the exchange rate for the rupee in regard to which, there were two contending views. Indian business opinion (supported later by the Congress Party) sought a restoration of the pre-war 16d. rupee, though the sole dissentient to the commission's report- a "professional dissenter" according to its chairman - was a reluctant convert to the idea.[87] The other view was held by the Government of India and the India Office establishment that the rupee should be stabilized at 18d. because it had stayed at that level for some months, though, this did not prevent the latter from seeking an appreciation of the rupee in the winter of 1925.

In itself, the exchange rate was not a question to arouse great emotion. But in the inter-war Indian situation, it caused more resentment than almost any other economic issue, and even officials in the Government of India seemed to have been possessed of a sense of dramatic intrigue when they were legislating to put the 18d. rate on the statute book.[88]

It is important to explain why this was so. The nationalists saw in the revaluation of the rupee, an attempt to reverse import substitution in the Indian economy especially in sectors that affected Lancashire and to neutralize the tariff gains made by India in the years after the Fiscal Autonomy Convention.

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87 IOLR L/PO/2/3(i), Hilton-Young to Birkenhead, note dated 1 July 1926; NMMA PT Papers, File 58, Madan to Majumdar, letter dated 26 February 1926. In the letter, Madan referred to prices as Thakurdas' "greatest difficulty" as he thought he had to demonstrate return to pre-war prices before he could justify a return to the pre-war exchange rate.

88 IOLR Mss.Eur.E397/32, Blackett to Strong, letter dated 21 December 1927 conveys the flavour of the manipulation and intrigue that surrounded the passing of the 18d. rate in the Central Legislative Assembly. See also the correspondence dealing with this question in Mss.Eur.D703/4-6.

Indian business suspicions of British Indian exchange rate policy on trade grounds seem, in retrospect, to have been excessive. There is no doubting that Whitehall and New Delhi wished to encourage Indian imports of British goods and discourage, to the extent possible, the utilization of the Fiscal Autonomy Convention to raise tariff barriers against British exports to India. But there is little evidence to show that the exchange rate was seen as an important instrument to accomplish the former objective. The India Office was aware of the possible effects of a rupee revaluation on Indian imports and cited the switch that the Indian consumer would make out of gold and into commodities, were the prices of the latter to fall. Therefore, the desire to seek a revaluation of the rupee arose, not with a view to preventing tariff autonomy from taking full effect, but more to prevent an undue absorption of gold by India on the non-monetary account.

Secondly, the deflationary consequences of a revaluation would have potentially acted to depress Lancashire's exports to India, though, whether the positive price effect or the negative income effect would dominate would have been hard to estimate. But the deflationary consequences of a currency revaluation were well known and in the Chinese case eight years later, cited by the Treasury as the reason why a Chinese revaluation would be ineffective in expanding British exports to her.[89]

A major problem in the "nationalist" view of the aims of British economic policy in India (which has been inherited by modern scholars who have attempted to either echo or refute the nationalist argument) lay in their separation of the trade and liquidity questions. The nationalists saw that Britain faced a problem of uncompetitive exports in some sectors. They also saw that Britain faced a post-war

[89] PRO T175/57, "Silver", Undated memorandum by Hopkins. The memorandum was probably written in the summer of 1934. It is significant that while Hopkins rejected a Chinese revaluation on income grounds, these considerations were overruled in the Indian case.

liquidity crisis.[90] But they perceived Britain as tackling the trade competitiveness problem (in the Indian markets) through the exchange rate instrument and believed that her liquidity crises affected India only through the denial of a gold standard. Rarely did they link the two questions, and at no stage did they see that the Indian exchange-rate was possibly being used to forestall India from worsening a British liquidity crisis in the short-term.

In the last chapter, we have suggested that the prolonged floating of the rupee was a device to ensure that India's gold absorption did not increase as a result of the widely expected US expansion. We have already referred to Blackett's 1923 warning regarding the "problems of an appreciated exchange."[91] Similar fears prompted Norman to write to Blackett in October 1924 (when the latter was moving to keep the rupee stable around 18d. sterling) opposing any **de-facto** stabilization of the rupee.[92] Norman preserved his opposition to Indian stabilization well up to the time of the Hilton-Young Commission. Speaking on Norman's behalf, Addis told the commission that the rupee should remain on a trend float - i.e., follow trade trends while smoothening out temporary fluctuations - till the European countries stabilized their currencies and the reconstruction of Europe permitted a better outlook on world prices.[93]

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[90] NMMA PT Papers, File 55, Part 1, Thakurdas to Gandhi, letter dated 27 February 1927.

[91] CCA Htry 1/3/1, Blackett's speech to Assocham, 4 December 1923, para 19.

[92] H.Clay, **Lord Norman**, 1957, p.219.

[93] IOLR V/26/302/8, Qns.13724-734. When Addis was giving this advice, France was the only major European power that had not stabilized. Secondly, it is hard to see what bearing the reconstruction of Europe had on world prices or why stabilization in India in advance of European reconstruction would leave Indian prices unhinged from world prices. The most likely explanation is that the British central bankers were still looking forward to the anticipated expansion of US lending abroad and domestic US expansion generally to lift the levels of activity and prices in Europe, render their new parities stable and ease the reconstruction process. An Indian stabilization - especially against gold, and with a role for gold as an intervention medium - would have led to increased Indian gold receipts and weakened the expansionary stimuli of an American-aided global inflation. It is also

The relation between the timing of Indian stabilization and the effect of it on Western liquidity during an US expansion is also reflected in an early question that Hilton-Young put to Blackett. He asked if the time had come to stabilize the rupee particularly as it was affected by the future of gold prices and changes in US monetary policy leading to a change in the availability of gold.[94] Blackett doubted that US expansion such as the one suggested by the questioner would take place. Kisch also talked of future US expansion being a "disturbance" that the India Office would have preferred to have out of the way, before they stabilized. However in the end, the pressures especially at the Indian end, including those from the Government of India (which was subject to political criticism in India for delaying stabilization), proved irresistible and the rupee was stabilized at 18d..

There is a good deal that is contradictory in the India Office approach to stabilization in India. We have referred often enough before to the deflationary bias in the use of the exchange rate instrument. Further, in the event of an US expansion taking place after the rupee parity was fixed, barring reasons peculiar to India such as perhaps a bad monsoon, Indian prices would rise broadly in line with world prices. As long as the inflation originated abroad, there was no question of India being in a price dis-equilibrium. If anything, the evidence from the First World War (even before the rupee was revalued and despite the absence of private gold imports) was that India's rate of inflation was often below the world rate. Hence, the mere fear of the effects on Indian prices of a US-led inflation was not

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useful to recall, in this context, the fear expressed by Hawtrey (Chapter **IV.1**) that while a US-led inflation was useful for European recovery, it could also lead to an increase in the non-monetary demand for gold, especially from India, and his suggestion that this might necessitate large permanent deflation at some stage. Postponing an Indian stabilization till these expansionary stimuli were exhausted (and in the meanwhile, securing a rupee revaluation) would have been one way of reducing the Indian gold demands arising from a US expansion.

[94] IOLR V/26/302/8, Qn.13.

a valid reason for postponing an Indian stabilization.[95] Lastly, in the previous chapter, we have referred to an argument used by the India Office to defer rupee stabilization. Listing the conditions under which the final decision about a rupee parity should be taken, Kisch noted that for rupee stabilization to be successful, world prices must be rising.[96]

In the light of the above, it is hardly of relevance to consider whether the rupee at 18d. was at equilibrium. Any economy would in due course generate, at some cost, adjustments to a new parity. However, the Hilton-Young Commission's arguments in support of its contention that the rupee had adjusted to 18d. is open to some doubt. On the other hand, the "nationalist" contention for the economy as a whole (as distinct from some sectors) that no adjustment had taken place to the new parity was weak and unproven in the minority report submitted by Purushottamdas Thakurdas.

The majority report cited two arguments in support of the view that 18d. gold represented the equilibrium parity. The first argument (paras. 182-187) was that, after a period when the movement of Indian prices corresponded to that of world prices (through 1923 and till June 1924 when the rupee was roughly at 15d. gold), Indian prices fell rapidly over October 1924 - September 1925 after the rupee rose

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[95] Also note that Britain was seeking to promote, simultaneously, the stabilization of European currencies and US inflation even when she was trying to defer an Indian stabilization on grounds of potential future inflation.

[96] See Chapter **IV.3**. It is possible to distinguish the disinterested view of Keynes on the timing of rupee stabilization from that of Norman and Addis. Keynes (Qns.12981-982) had opposed rupee stabilization because of uncertain world conditions and suggested setting the rupee on a managed float with a view to preserving domestic price stability. His recommendations for India were similar to those for Britain. On the other hand, Norman who had disregarded domestic price stability and employment in the process of Britain's return to gold, was urging deferred stabilization in India to give her the benefit of stable prices. It may be recalled here that during and immediately after the First World War, the effect of a world inflation on Indian reserves and Indian gold imports were regulated by successive revaluations of the rupee.

towards 18d..

Valid though this reason appears, there was no way of judging (when the Hilton-Young Commission was finalising its report) that the adjustment of prices to 18d. was complete or that the 18d. rupee would not trigger further deflation after Indian and world prices had reached roughly the same levels in relation to 1913 prices. The latter was seen by some members of the commission as evidence that Indian prices had adjusted to world prices. For example, as early as September 1925, Strakosch was "supposing" that Indian prices had adjusted to the 18d. rupee.[97] Secondly, the commission completely begged the question as to why it was necessary to seek a rise in the rupee and an autonomous fall in Indian prices, when, before the rupee had begun to appreciate towards 18d., "movements of world prices and of Indian rupee prices (had) broadly corresponded ...."[98]

The omission becomes especially important because later on, the **Report** proceeds to cite a second reason why it believed the rupee was in equilibrium at 18d.. During the previous twelve months, the "steadiness of exchange" was a "further indication of equilibrium between internal and external prices .... When exchange remains steady over a fairly long period it may ordinarily be inferred that there are no differences to be adjusted."[99] The report then went on to deny that the rupee had been kept at 18d. through monetary management.

The above is a surprising travesty of facts that throws the commission's reasoning process open to doubt. It also flies in the face of all the evidence we have summarized in the last chapter according to which, severe currency contraction had

[97] CCA Htry 1/3/2, Strakosch to Blackett, letter dated 28 September 1925.

[98] IOLR V/26/302/8, Para 186.

[99] IOLR V/26/302/8, para 189.

led to 18d. and thereafter, at the insistence of the Indian government and owing to its policy on remittances, the rupee was held at that rate. Therefore, it was not only the issue and withdrawal of emergency currency mentioned in the report but the decision of the Indian government to sell remittances (almost without limit despite London's opposition to the move) at 18d. which stabilized the rupee for well over one year. As McWatters of the Finance Department of the Government of India said in his memorandum to the Hilton-Young Commission, after the rupee reached 18d. in October 1924 the Government of India had striven to prevent a further rise and "more recently (above) the upper gold point of approximately 1s 6 $^{3}/_{16}$d."[100] Blackett and Kisch, among others, confessed that the rupee had reached 18d. through a process of deflation and that, once there, intervention was designed to stabilize at that level rather than seek a revaluation.[101]

In fact, as late as in the winter of 1925, even while it was asserting to the commission that costs and prices in India had adjusted to the 18d. rate, the India Office was trying to restrain monetary expansion to secure a further appreciation of the rupee, on the grounds that it did not want to pre-judge the ratio in advance of the commission. The Government of India managed to resist these pressures. However, the communications between London and Delhi on this subject throw light firstly, on the importance that the India Office attached to securing as high a rupee parity as possible. Secondly, these exchanges also shed light on the India Office seeking, without any apparent sense of irony, reverse sales and currency contraction to preserve a stable rupee in the face of downward pressures only five months later in March 1926.

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[100] IOLR V/26/307/2, App.3, McWatters' memorandum to Hilton-Young Commission, Vol. II, pp.18-19.

[101] IOLR V/26/302/8, Qn.10479, Qn.11830. Also see SOAS Addis Papers, Pp.Ms.14/557, Addis' draft reply to Brunyate dated 12 November 1926.

The unusual exchanges between the Government of India and the India Office on exchange rate policy for the 1925/1926 busy season began, for all practical purposes, late in September 1925 when the India Office officials began pondering the advisability of pushing up the rupee. A telegram from the Secretary of State asked the Government of India whether, given the recent firmness in the market for rupees and a good monsoon, "Indian interests" did not "indicate that exchange should ... be allowed to move appreciably" over 18d. It sought the opinion of the Indian government on whether unlimited remittances should be made at 18 $^{7}/_{32}$d. (approximating to an upper gold point on 18d.) or whether the rupee should be allowed to rise. An addition in Kershaw's hand said that any action taken would impinge on the findings of the currency commission. The telegram added that the size of the busy season expansion in money supply should depend on how far the rupee should be made to rise.[102]

The Indian government replied that good cotton and rice crops made a large increase in currency inevitable and there was no advantage in postponing it. The India Office commented on the margin "(but) the increase might be less". Secondly, the Government of India said, the system should be made to approximate to an automatic gold standard, which, had it been in force, would have led to gold imports and currency expansion to keep the rupee down. The India Office commented again on the margin "(this) assumes a final 1/6". The Government also added that if demand for rupees did not have a full impact, sterling offers to the Government of India would increase.[103] Another Indian telegram said that the Indian government's policy was to expand currency on the "considerable scale ... necessary while maintaining the exchange at present figure." Action to push up the

[102] IOLR L/F/6/1078, F.4516, Secretary of State to Viceroy, letter dated 16 September 1925.

[103] IOLR L/F/6/1078, F.4516, Viceroy to Secretary of State, telegram dated 17 September 1925.

rupee beyond 18d. was inadvisable because of opposition from Bombay and the announcement of the currency commission.[104]

Remarking on the above telegram, Kisch complained that New Delhi seemed unwilling to allow the rupee to increase beyond 18d. gold, but slack season remittances of 20 million pounds suggested that they should be asked to restate their views. The question for the Secretary of State was whether he should accept a 18d. rupee or push for a rise if circumstances indicated it. He said further that the commission's freedom of action would be impaired if the Government of India prevented a rise in exchange by following a free remittance policy.[105]

The India Office reply to the Indian government's view was along the same lines. It insisted that rupees would have to be sold without limit in order to prevent its rise and that could be excessively expansionary, especially if the monsoons failed. Therefore the Secretary of State could not commit himself to keeping the rupee at 18d. Further any such move would present the commission with a **fait accompli** when it commenced its deliberations. Therefore, if, in the future, market conditions pointed that way, the rate for remittances should be allowed to move to 18 $^{7}/_{32}$d. which was sufficiently near the gold import point to avoid arousing fears of a change of policy.[106]

This particular exchange ended with a formal acknowledgement of the position on either side.[107] However, the India Office interpreted its agreement with the

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[104] IOLR L/F/6/1078, F.4516, Viceroy to Secretary of State, telegram dated 18 September 1925.

[105] IOLR L/F/6/1078, F.4516, minute by Kisch dated 22 September 1925.

[106] IOLR L/F/6/1078, Secretary of State to Viceroy, telegram dated 24 September 1925.

[107] IOLR L/F/6/1078, Viceroy to Secretary of State, telegram dated 9 October 1925 and minute by Kisch dated 12 October 1925.

Government of India to mean, not that the latter would buy sterling to prevent the rupee going above 18 $^{3}/_{16}$d., but that it would not intervene in the market below that rate. In other words, the India Office was once again setting the floor for the rupee at the previous year's ceiling.

The above exchange is noteworthy for several reasons. Firstly, the reason used to justify contractionary policies during the years in which sterling and the rupee were floating was the need to insulate the Indian economy from global inflation. But the case for a rupee appreciation continued to be pressed by the India Office even after world conditions had settled down, i.e. the sterling had returned to gold at the pre-war parity and world prices had actually begun to move in a downward direction.[108] The criteria for exchange rate policy was no longer the need to stabilize prices, but the potential for an appreciation - "market conditions pointing that way". Secondly, the India Office feared that a bad monsoon would render monetary expansion based on 18d., excessive. This suggests, a) that the India Office was keen to secure revaluation no matter what the conditions of Indian trade were, or at least to ensure that the appreciation thus far secured would not be lost through an expansion programme based on a 18d. rupee, b) that they were quite insensitive to the income effects of a monsoon failure in their quest for a revalued rupee, and lastly c) if their intention was not to present the Hilton-Young Commission with a **fait accompli**, then, curbing expansion in anticipation of a bad monsoon amounted to setting a floor for the rupee which the commission could not breach.

That the India Office's desire to prevent a permanent rupee parity from taking effect in advance of the commission related only to the upper point and not to the lower point becomes evident in the discussion of slack season exchange rate policy in the spring of the following year. After the exchanges referred to in the

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[108] See Table **IV.1** above.

previous paragraphs, there was a silence of some months till the rupee fell below 18d. in March 1926. Reversing their earlier distaste, the India Office began quite suddenly to see the virtues of ensuring a "stable position for the fixation of exchange." A minute by Kisch said, referring to the fall in the rupee, that the Government had taken a hand at pegging the exchange by selling unlimited remittances at 18 $^{3}/_{16}$d., whereas otherwise, the rupee would have risen. A stable exchange was a "necessary preliminary which must be adopted in the case of any country with an unstable exchange which contemplates stabilization." Successful stabilization demanded equating the "internal and external purchasing powers of the currency ... by the rate of exchange ..." and (ignoring everything to the contrary that the India Office had argued in the winter) said, unless there was a period of "quiet nursing" these pre-requisites would be unobtainable.[109] The telegram to India drafted on the basis of this minute asked the monetary authorities in Delhi to be prepared to intervene to prevent a fall in the rupee. The "recent policy of holding upper limit of exchange at 1s 6 $^{3}/_{16}$d. was directed towards establishing an equilibrium between internal and external prices which would facilitate stabilization of the rupee at 1s/6d gold."[110]

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[109] IOLR L/F/6/1078, F.4516, Kisch's minute probably dated 19 March 1926.

[110] IOLR L/F/6/1078, F.4516, Secretary of State to Viceroy, telegram dated 19 March 1926. Note that the India Office was now talking in terms of "facilitating" the fixing of the rupee at 18d. gold. This suggests that it had reconciled to the 18d. rate between October 1925, when its hopes of securing a further revaluation had been dashed, and March 1926. It is not improbable that the India Office had come to accept this rate after informal talks with members such as Strakosch, Mant and Hilton-Young himself. By March 1926, as we have pointed out earlier, Strakosch had begun to work out the gold points for the rupee on the basis of a 18d. rate.

B.R.Tomlinson, "Monetary Policy and Economic Development: The Rupee Ratio Question, 1921-1927", in C.J.Dewey and K.N.Chaudhuri (eds.) **Economy and Society: Essays in Indian Economic and Social History**, New Delhi, 1977, p.203 is broadly right in commenting that the Government of India "managed to hold" the India Office in 1925 to the exchange rate that prevailed during the previous busy season. But he ignores the fact that the India Office developed arguments against rupee stability when the rupee was showing signs of rising but jettisoned them as soon as the rupee threatened to fall.

Another India Office minute highlighted the irony of the switch in its attitude. Discussing the options open to the Government of India, were the rupee to fall below 17 $^{25}/_{32}$d., Kisch said a fall in the rupee would affect the basis of Indian trade. The existence of the commission complicated matters but if "India's interests require that stability of exchange should be preserved, government can scarcely be expected to abandon its functions because a Commission is in existence"! The 18d. rate had preserved price equilibrium and it should be maintained, if necessary with reverse sales. "No other course will be in accordance with India's highest interests."[111]

It is hard to believe in the light of the evidence presented in the previous two chapters that the price stabilization argument for a rupee float was more than an alibi for a policy that was quite deliberately designed to secure as high a rupee-sterling exchange rate as was possible in the circumstances. Though they seemed to have differed on the actual extent, there is no doubt that the India Office and the Government of India were both keen to secure a revaluation and for the most part, monetary policy was oriented towards that end. The empirical evidence and the evidence from the records we have cited in the previous chapter and to a certain extent in the present one. In our reading of the evidence, the essential motive was to switch the portfolio preference of the Indian house-holder to make him take more commodities rather than gold. He could thereby make his contribution towards mitigating Britain's liquidity shortage. The constraints on permissible deflation in Britain meant that policy in India had to be oriented towards keeping her demands for commodities and liquidity more in line with the requirements of the centre. One outcome of this policy was that the boom of the 1920s "virtually by-passed India".[112]

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[111] IOLR L/F/6/1078, F.4516, Kisch's minute dated 25 March 1926.

[112] D.H.Aldcroft, **From Versailles to Wall Street, 1919-1929**, London, 1977, p.216.

V.4 AFTER THE REPORT

Even as the Hilton-Young Commission's report was being written, the rupee was showing signs of weakness which continued till the end of 1927. By March 1926, as described earlier, the India Office was demanding that the Government of India take steps to intervene in the market to prevent a fall in the rupee.

The Government of India believed that the rupee was weak in March 1926 because of the "dead set against the rupee of the politico-speculator group in Bombay" who sought a 16d. rupee and had made speculative transfers into sterling against that expectation. But as Blackett explained to Benjamin Strong, the facts were on their side. Though prices had seemed to have adjusted to 18d. by March 1926, a poor harvest, slowing down of exports, the resulting redundancy in rupees and the liquidation of silver rupees in hoards, tended to weaken the rupee. The monetary authorities were caught in a dilemma because, as the commission was still sitting, the rupee parity was "supposed to be an open question" and they would have been vulnerable to the charge of manipulation if they did anything to strengthen the rupee. But nevertheless, the government contracted against sterling and did just enough to keep the rupee within the gold points.[113]

Through the latter part of March and April 1926, the weakness of the rupee emerged as the chief focus of concern in the Finance Departments of the India Office and the Government of India. Initially, the former sought contraction in order to prevent a politically embarrassing sale of reverses. Should contraction not

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113 IOLR Mss.Eur.E397/32, Blackett to Strong, letter dated 21 December 1927. Blackett's view that the rupee weakened in March 1926 because of a bad monsoon underlines the views of some witnesses who told the commission that the rupee could reach 18d. only because of four good monsoons. See for example the evidence of D.P.Khaitan in IOLR V/26/302/8, Qns.8080-8086. Also see Thakurdas to Blackett, Qn.10493.

prove sufficiently effective, it sought an unlimited commitment by the Government of India to sell reverses against Treasury bills in the Paper Currency Reserve.[114] The Government of India complied and ordered contraction to the extent of Rs.30 million against transfers from the Currency Reserve to the Home Treasury balance in London. It hoped that this would suffice to strengthen the rupee and that no reverse sales would be necessary.[115] But barely a week later, the rupee had fallen sufficiently to force the Government of India to instruct the Imperial Bank of India to sell reverses at 17 $^{3}/_{4}$d.. The Indian authorities expected the announcement effects to be strong enough to strengthen the rupee and that actual sales would not be necessary, and so it proved.[116]

The majority report of the Hilton-Young Commission said (para 189) that the fact that no reverses were sold in April 1926 proved that the "volume of currency had adjusted to the 18d. ratio." It regarded the contraction of Rs.80 million beginning in April 1926 as a normal slack season contraction which was the counterpart of the busy season expansion of Rs.90 million. But both the India Office and the Government of India agreed at the time that the exchange rate was the target of the contraction.[117]

Between April 1926 and January 1927, deflation required to keep the rupee close to 18d. was the major preoccupation in the exchanges between the Government of India

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114 IOLR L/F/6/1078, Secretary of State to Viceroy, telegram dated 31 March 1926 and "Note on Exchange" by Kisch dated 1 April 1926.

115 IOLR L/F/6/1078, Viceroy to Secretary of State, telegram dated 2 April 1926.

116 IOLR L/F/6/1078, F.4516, Viceroy to Secretary of State, telegram dated 7 April 1926.

117 IOLR L/F/6/1078, F.4516, Secretary of State to Viceroy, telegram dated 20 April 1926 and Viceroy to Secretary of State, telegram dated 24 April 1926. The commission's argument to explain slack season contraction in April 1926 did not provide room for monetary expansion which, since the velocity of money and the development of banking institutions would remain unchanged in the short-term, was necessary to support rising volumes of business activity.

and the India Office and the object of policy. There was some difference between London and Delhi on the precise method of deflation, namely whether deflation should be achieved through the retirement of ad-hoc securities as New Delhi sought, or against reserves as the India Office desired. The Government of India was also inclined to be somewhat more cautious in regard to its extent, but in general, they were united on the need for contraction to stabilize the rupee at 18d..[118]

According to the official figures of the Government of India, the net contraction of note issue effected between 1 April 1926 and 7 February 1927 was Rs.133.1 million. But the net figures were arrived at after deducting the notes issued against silver bullion and demonetized silver rupees returned to the Treasury offices, from the total contraction effected. The assumption underlying these net figures - as the India Office was aware - was that the silver returning from the public did not come from active circulation but from hoards.[119] Thus, to the extent that the new issues were replacing rather than adding to existing currency, the actual size of the contraction would have been larger than the Rs.133 million claimed by the Indian authorities, though, a part of the Rs.174.1 million issued against silver would have represented the liquidation of hoards.

Apart from contraction, other methods were used to steady the rupee at 18d. These included the refusal to sell rupee remittances with the result that the bulk of the home transfers over 1926/1927 was remitted through the reserve. Reverse councils

[118] See IOLR L/F/6/1090, F.3218, Secretary of State to Viceroy, telegrams dated 26 June, 6 July, 1 September, 13 October, 19 October and 4 November 1926 and Viceroy to Secretary of State, telegrams dated 2 July 1926, 13 July 1926, 24 August 1926 and 16 October 1926. Also see the notes of the Finance Department officials in London in the above file; especially notes by Kisch dated 21 July and 18 October 1926 and 10 January 1927. Also see IOLR L/F/7/2286, Colln.375, F.15, Viceroy to Secretary of State, telegrams dated 2 July 1926 and the telegram in the opposite direction dated 7 July 1926. For Blackett's account see IOLR Mss.Eur.E397/2, Blackett to Strong, letter dated 21 December 1927.

[119] IOLR L/F/7/2276, Colln.375, F.5, Blackett's reply to Purushottamdas Thakurdas dated 16 February 1927 and undated India Office note attached to it.

were also sold in December 1927. Emergency currency was not issued in the busy season of 1926/1927 although the rate of interest touched 7 per cent. The latter measure, in the short- term, had the effect of forcing the market to sell sterling to the Government of India who, between 13 January 1927 and the end of March, were able to make purchases of about 2 million pounds in the market.[120] As a result of these contractionary measures, gross circulation of coin and notes fell from about Rs.1967 million in September 1926 to Rs.1841 million in March 1927 while in the same period in the previous year, it had risen from Rs.1841 million to Rs.1933 million. In fact, if one makes a month-to-month comparison of note and coin circulation figures for the 1925/26 and 1926/27 financial years, in eight months out of twelve, the figures for the latter year were lower than those for the corresponding months in the former year. The average annual figures were also lower at Rs.1801 million for the latter year as compared to Rs.1892 million for the former.[121]

The effects of the 18d. rupee were almost immediately evident. Despite the US-induced global expansion that lasted till 1928, the Indian trade surplus actually halved between 1925/26 and the following two years. Indian gold imports fell from 52 million pounds or (65% of total gold output) in 1924 to 27.8 million pounds in 1925 (34% of total output) and to an average of about 15 million pounds per year in the next four years, which amounted to between 15-20% of the world output's of the metal. The absolute amounts, and the proportions of Indian gold imports to total gold output, were lower in these four years than in the last decade before the

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[120] See NMMA PT Papers, File 52, p.29, undated note by Madan referring to a **Financial Times** story of 15 February 1927 and Thakurdas to Government of India, Finance Department, letter dated 18 February 1927. See also the **Statist** of 12 February and 11 June 1927.

[121] Government of India, **Reports of the Controller of Currency**, various years.

First World War.[122] The rupee itself was below the 18d. parity throughout the month during eight and six months respectively in 1927/28 and 1928/29. In 1929/30 and 1930/31, the rupee never reached 18d. Only during five of the ten months in 1927/28 and 1928/29 when the rupee touched 18d., was it at or above that level throughout the month. Not surprisingly, in these four years, the sales of council bills were not sufficient to cover the home charges. After three years (1924/25-1927/28) when no long-term sterling loans had been raised, during the next three years 35 million pounds were raised on the Indian government account in London besides 11 million pounds through short-term bills. A further 13.5 million pounds were remitted through the reserves.[123]

It was against the background of a rupee that was seen by the markets to be overvalued even before prices collapsed in the depression, a halving of the Indian trade surplus and the loans incurred and the contraction undertaken to meet the fixed external obligations of the Indian government that the great depression came to India.

V.5 SUMMARY

The Hilton-Young Commission was appointed to go into Indian currency matters soon after the sterling returned to the gold standard. Until then, for reasons already discussed in the previous chapter, an Indian stabilization would not have been in the British interest. There were two main questions before the commission. The first, of course, was the rate at which the rupee was to be stabilized. The

[122] League of Nations, **Report of the Gold Delegation**, Geneva, 1932, Tables I and II.

[123] Rupee parity figures are from IOLR L/F/7/897, Colln.107, Central Legislative Assembly Proceedings, 23 February 1931. Figures for sterling issues and remittances from Western India Liberal Association to Secretary of State, letter dated 13 March 1931 in the above file and IOLR L/F/5/100, Financial Department Statistics.

second related to the design of the Indian currency system. Indian nationalist opinion believed that rupee revaluation was a means of denying Indian manufacturers (especially of cotton textiles) the full benefits of post-war tariff policy. Modern scholars have examined this charge and found little direct evidence to support it. In terms of the analysis carried out in this chapter and in the previous one, the actual aim of British exchange rate policy in India was somewhat more complicated. The only consistent picture that emerges from the mass of confusing and often contradictory evidence is that the Indian monetary authorities saw that delayed stabilization and a process of rupee revaluation would firstly reduce India's reserve accumulation, especially when the latter would be aided by the hoped-for expansion in American lending abroad. On the private account too, a rupee revaluation would make Indian commodity imports seem cheaper in relation to gold and the Indian house-holder might be induced to import more commodities and less gold. It is possible to pick holes in this model but there is no denying that officials in Whitehall and in Delhi used this as a guide for policy through the years after the First World War.

The second question facing the commission was relatively straight-forward. Given Britain's fear of a gold drain to India, it was improbable that the Treasury would have acceded to the Indian demand for a gold standard. But the extent of its role and the scale of mobilization effected to defeat the proposal are worthy of note. The collaboration between the British and American authorities on this question, in fact, recalls their cooperation during the war to switch India's asset demands away from silver and towards gold, that was discussed earlier. The commission rejected a gold standard for India also because of its effects on silver, but as we have suggested in this chapter and discuss in the following one, the British concern for silver was self-serving rather than genuine. Not unexpectedly, the commission proposed a gold-bullion standard for India with some role, on paper, for gold reserves. But as we have seen, the buying and selling prices of gold were so fixed as to minimize the possibility of gold moving to India to finance trade. It was expected that India's exports would continue to be financed by the sale of council bills and that the new system would function in effect as a sterling standard. So it proved. The Indian government and Indian business opinion saw the gold bullion standard as an intermediary step towards a full gold standard. Some sections of the latter were inclined, in fact, to accept the 18d. rate, which they had earlier opposed, because they expected that the new system was closer to a gold standard and that it would be more automatic than a sterling system. But they were to be proved wrong again.

CHAPTER 6

The Depression Years

In this chapter, we extend our discussion of the external constraints on Indian monetary policy into the period of the great depression. For the Indian economy, the depression represented an intensification of the trends visible in its relationship to the world economy during much of the 1920s, rather than a qualitatively new phenomenon. For a brief period in 1928, it seemed as if, with the rupee almost stable and the terms of trade returning to the 1913 level, the clouds over the Indian economy and its trading links were beginning to clear.[1] But the breathing space of 1928 was the attenuated form in which that year's global expansion came to India. The slump which began in the following year was to affect India much more dramatically.

Even in the relatively trouble-free year of 1928, some problems were evident. Trade remittances still did not cover current account obligations which had to be financed by sterling loans. But the latter might be attributed to the short-term cost of infrastructure-building, which was being incurred faster than the ability of the current account to sustain the repayments. The obligations that fell due in 1928 also represented maturities of loans incurred to support the rupee on a managed float. Their proceeds had been used to meet current account obligations as normal trade remittances were suspended to secure an appreciation of the rupee.

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[1] Source for terms of trade, same as in Table **IV.1** above.

Therefore when the depression came, the Indian economy was not well equipped to weather its impact. Having just undergone one bout of deflation, it was about to experience another.[2]

Expectedly, the great depression would have affected the Indian economy through its effect on trade. But, the Indian trading sector was small in relation to the whole economy, and in the normal course, the impact should have been easily containable. The excessive influence of trade financing upon monetary expansion together with fixed debt obligations ensured, however, that policy would be pro-cyclical rather than anti-cyclical.[3] The official commitment to free short-term capital flows had the same effect.

This chapter is organized as follows. The first section summarizes the impact of the depression on Indian trade. The second section discusses our view of the metropolitan constraints within which policy was formulated in the depression years. The third section discusses a significant outcome of the depression, viz., Indian gold exports and places them in the context of the objectives of British-Indian financial policy in the inter-war years. The fourth discusses the gold glut that occurred for a brief period before the Second World War. Section five is in the form of a conclusion.

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[2] The Government of India as also some Treasury officials realized that the Indian deflationary crisis pre-dated the depression. See PRO T160/519, F.12471/05/4, "Reserve Bank of India : Notes on Reserves and Currency Policy", memorandum by George Schuster, Finance Member of the Viceroy's Executive Council, Government of India. Hawtrey, commenting on Schuster's memorandum, identified three deflationary phases in the Indian economy between 1920 to 1931. 1920-23 was a heavily deflationary period when there were negative remittances; 1929-31 had been years of deflation the world over; even the intervening years, 1923-29, were "to some extent deflationary" because the rupee was raised to 18d. See his memorandum, "Indian Balance of Payments" dated 9 August 1933 in the same file.

[3] Dharma Kumar, "Fiscal System" in Dharma Kumar and Desai, M., eds., **CEHI**, Vol.2, Chapter 12, p.942.

VI.1 THE DEPRESSION : IMPACT

The great depression directly affected the Indian economy through its external economic relationships, and to this we will first turn.

Between 1926/27 and 1929/30, India's non-gold commodity exports and imports did not change dramatically, though a slight drop is evident in the last of these four years. India's exports rose from Rs.3320 million in 1926/27 to Rs.3663 million in 1928/29. It declined in 1929/30 to about Rs.3400 million, but this decline was hardly as steep as that in 1926/27 from the figures in the previous year. (Indian exports had fallen from about Rs.4100 million in 1925/26 to Rs.3300 million in the following year). Indian imports also remained fairly steady during these four years and it was not till 1930/31 that both fell steeply. The immediate effect of the depression on Indian trade was a decline in both the volume and value of its exports.[4] As is evident in Table **VI.1**, by 1932/33, India's exports at Rs.1460 million (all current prices) were only about 40% of their level in 1928/1929. Exports increased to Rs.1635 million in 1933/34. The decline in imports lasted a year longer than that in exports and hit the floor at Rs.1360 million in 1933/34, down from about Rs.3000 million in 1928/29.

Not unexpectedly for a country that predominantly exported primary products, the terms of trade moved against India. Table **VI.2** below summarizes the position of Indian trade values and prices in the depression years. The fact that the percentage decline in the value of exports and imports exceeded the percentage fall in prices shows that trade volumes also declined.

Even in 1926/27, the Indian trade surplus was down greatly from the historically

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[4] See Tables **VI.1** and **VI.2** below.

TABLE VI.1 THE INDIAN CURRENT ACCOUNT: 1926/27 - 1937/38

Year	1	2	3	4	5	6
26/27	3320	2969	-194	-298	-347	-488
27/28	3529	3016	-181	-314	-347	-329
28/29	3663	2998	-325	-312	-212	-183
29/30	3404	2867	-316	-180	-142	-100
30/31	2442	2071	-336	-159	-128	-251
31/32	1740	1518	-348	-179	580	275
32/33	1460	1515	-344	-162	655	95
33/34	1635	1364	-339	-122	571	380
34/35	1707	1594	-325	-139	525	174
35/36	1821	1628	-320	-160	374	88
36/37	2175	1608	-324	-183	278	338
37/38	2050	2050	-302	-181	163	-320

All figures are rounded off to the nearest Rs.million

1. Non-treasure commodity exports; 2. Non-treasure commodity imports; 3. Interest and dividend flows; 4. Other service items; 5. Gold flows; 6. Total current account surplus (+) or deficit (-).

Source: "Government of India's Estimates of India's Balance of Payments during 1923-24 to 1938-39 as submitted to the League of Nations", Table XLVII in A.K.Banerji, **India's Balance of Payments : Estimates of Current and Capital Accounts from 1921-22 to 1938-39**, London, 1963, pp.236-37.

TABLE VI.2 INDIAN TERMS OF TRADE : 1927-1936

Year	Export price	Import price	Terms of Trade
1927/28	100.0	100.0	100.0
1928/29	97.5	96.4	100.1
1929/30	90.2	93.2	96.1
1930/31	71.5	80.0	89.4
1931/32	59.2	71.7	82.6
1932/33	55.3	65.2	84.8
1933/34	53.5	63.5	84.3
1934/35	54.1	63.0	85.9
1935/36	56.9	62.1	91.6
1936/37	57.2	62.8	91.0

Source: **Annual Review of the Trade of India**, cited in K.N.Chaudhuri, "Foreign Trade and Balance of Payments", Chapter X in Dharma Kumar and Desai, M., eds., **CEHI**, Vol.2, p.840.

high levels reached over 1923/24 - 1925/26. After peaking in the last of these years at Rs.1189 million, the surplus fell to about a third in 1926/27 and rose to Rs.665 million in 1928/29. The next year, with the first signs of the depression, the surplus fell to Rs.538 million and further to Rs.371 million in 1931/32. The instability of the Indian trade account in this period therefore predated the depression.[5]

Despite the fall in her exports, India ran a trade deficit only in 1932/33. In the first two years of the depression, i.e., 1929/30 and 1930/31, India continued to be a net importer of gold, though Indian gold imports had been reduced to a trickle.

However, in the next three years, India emerged as a net exporter of gold, which together with the surplus on the non-gold merchandise account (or even after being offset by a small deficit in 1932/33) meant that India, with a current account in surplus, discharged a part of her external debt or in some years, even expanded her lending abroad. Gold exports persisted till 1938/1939 and India ran a current account surplus till 1936/37. It is worth noting that even without her gold exports, India's commodity trade would have been in surplus during much of this period. India could have run a current account deficit, which could have been financed through borrowing had such finance been available. Given the conditions of the world capital markets and the British external liquidity position, Indian gold exports functioned in effect as an useful variable. As contemporaries freely acknowledged, for a period during the depression, Indian gold exports were the single most

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[5] Same as in Table **VI.1** above. These figures relate to merchandise trade and do not take gold movements into account. In 1926/27 and 1927/28, net Indian gold imports amounted to Rs.347 million each year. Gold imports began to decline as early as 1928/29. With net gold imports in that year of only Rs.212 million, the trade surplus (net of gold) rose to Rs.453 million. In 1929/30, net gold imports actually fell faster than the merchandise surplus and cushioned the fall in the overall trade surplus. Gold imports continued to fall in 1930/31, but the non-gold merchandise surplus fell by more. From the next year (1931/32) of course, net gold exports more than offset declining trade surpluses.

important expansionary influence operating in the world economy and the most important source of support for the sterling. But, they did not have as great an expansionary domestic impact as they might have had, though certainly they would have contributed towards mitigating the impact of the depression on living standards, such as the latter were.[6]

There was a dramatic increase in the outflow on account of interests and dividends after 1926/27. These rose from Rs.194 million in that year to about Rs.330 million in the following year and stayed near that level for the next ten years. The increase in outflow under this head represented partly the increased debt-service obligations of the Indian government and partly the repatriation of earnings on investments which were not, as hitherto, being reinvested in India. Outflow on account of other services declined in the depression years as trade declined, from Rs.312 million in 1928/29 to about Rs.165 million annually over the next ten years.

With declining gold imports and outflows on account of "other services", the Indian current account did not deteriorate alarmingly even in the years before gold exports

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[6] Apart from the direct trade effects of the depression, there were many indirect effects. The impact of the depression on the Indian economy and in particular, her rural sector, has been discussed in D.Rothermund, **An Economic History of India**, London, 1988, pp.96-99, and his "British Trade Policy in India during the Great Depression", **IESHR**, Vol.18, Nos.3-4, 1981, pp.349-376. Also see "The Great Depression and British Financial Policy in India, 1929-34", **IESHR**, Vol.18, No.1, 1981, pp.1-18. For a discussion of the impact of the depression on rural credit, see C.J.Baker, **An Indian Rural Economy, 1880-1955 : The Tamilnad Countryside**, New Delhi, 1984, pp.297-99.

Inevitably, the depression affected the Indian national income. According to Sivasubramaniam's estimates, the national income fell after 1929/30 and began recovering very slowly, so that, it was not till 1934/35 that the 1929/30 levels were reached. According to Heston's estimates, the return to the 1929/30 level did not take place till 1937/38. Further, according to Sivasubramaniam, the bulk of the decline took place in the primary sector while incomes in the secondary sector fell by less or rose slightly. See Heston, "National Income" in Dharma Kumar and Desai, M., eds., **CEHI**, Vol.2 and Goldsmith, R., **Financial Development**, 1983, p.69. This trend is in keeping with that in the larger Latin American economies whose secondary sectors grew strongly in the depression. According to both Sivasubramaniam and Heston, per capita real incomes fell from about Rs.171 in 1930 to Rs.166 in 1935, a fall of about three per cent.

began to make their presence felt. As a proportion of her non-gold export receipts, the Indian current account deficit was about 10% in 1930/31. Though this represented an increase over 1928/29 and 1929/30 when the corresponding proportions had been 5% and 3% respectively, it was at about the same level as in 1927/28 and less than what it had been in 1926/27 (15 per cent).

The most serious changes were on the capital account (Table **VI.3**). In 1926/27 there had been net long-term capital inflows of Rs.383 million (about 80% of the current account deficit) and net short-term inflows of Rs.104 million. In the next year, net long-term capital inflows dropped sharply to Rs.147 million (or about 45% of a reduced current account deficit) while net short-term capital inflows increased to Rs.182 million and financed more than half the current account deficit. In 1928/29, this trend was even more marked. Net long-term capital inflows were reduced to a trickle (Rs.5.2 million) while short-term capital inflows remained at about the level reached in the previous year and financed almost the entire current account deficit.

Long-term capital inflows picked up in 1930/31 and 1931/32 largely because of increased government borrowing. But the major source of weakness in the Indian balance of payments (as those of other countries on the periphery) during these two years was the volatility of short-term funds. A net short-term capital inflow of Rs.178 million in 1928/29 became a net outflow of Rs.33 million in 1929/30 and Rs.181 million in 1930/31. It increased to Rs.393 million in the following year before declining thereafter.

In the section that follows, we discuss the response of the British and Indian financial authorities to the developments of the depression years and the constraints within which policy was formulated.

TABLE VI.3 THE INDIAN CAPITAL ACCOUNT: 1926/27 - 1937/38

Year	1	2	3	4	5
26/27	476	92	107	3	488
27/28	182	35	248	66	329
28/29	145	140	179	-	184
29/30	204	71	41	74	100
30/31	484	52	-	181	251
31/32	358	240	-	393	-275
32/33	128	193	52	82	- 95
33/34	254	469	-	96	-312
34/35	37	124	-	106	-192
35/36	n.a	n.a	n.a	n.a	-121
36/37	n.a	n.a	n.a	n.a	-333
37/38	n.a	n.a	n.a	n.a	53

All figures are rounded off to the nearest Rs.million.

1. Long-term capital inflows; 2. Long-term capital outflows;
3. Short-term capital inflows; 4. Short-term capital outflows;
5. Net capital flows [(-) indicates net outflows].

Source : A.K.Banerji, **India's Balance**, 1963, pp.236-37.

VI.2 THE CONSTRAINTS AND THE RESPONSE

There were two broad types of constraints within which policy in India during the inter-war depression had to be formulated. Firstly, the servicing of the sterling obligations of the Government of India was the chief priority and all other considerations were secondary to this. In fact the only criteria used by Whitehall officials to judge the "recovery" of the Indian economy in the depression were those related to India's ability to meet sterling obligations. Monetary and fiscal policies were oriented towards this objective.

As a result, the Indian economy did not derive the same degree of freedom during the depression years as some Latin American countries. Britain's relative orthodoxy on external debts and its effect on growth in the indebted countries during the depression has attracted some comment in the Latin American context. In a comparison of the Brazilian and Argentinean experiences, it has been suggested that the latter's dependence on British markets restricted her freedom of action, while Brazil's relative independence enabled her to exercise greater freedom of policy. She could pursue policies aimed at growth rather than merely ensuring the servicing of current account obligations. The difference between the external environments of these two countries is said to have made a significant difference to their respective growth outcomes during the depression years.[7]

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[7] See M.de P.Abreu, "Argentina and Brazil", in R.Thorp ed., **Latin America in the 1930s**, 1984, pp.144-62. However even the Argentinean case provides an useful contrast with the Indian one. Rather like India, Argentina also faced large withdrawals of British owned short-term balances. While servicing its long-term debts diligently, Argentina froze foreigners' access to short-term assets. The latter were unfrozen only when the government floated (with British support) a long-term loan to fund the short-term transfers. Argentina discovered that the costs of leaving short-term debts unfettered were greater than the benefits, while there were gains in punctually servicing longer debts. See B.Eichengreen and R.Portes, "The Anatomy of Financial Crises", in A.K.Swoboda and R.Portes, eds., **Threats to International Financial Stability**, Cambridge, 1987, p.25.

In the Indian case, the British influence was more direct, though arrangements along the lines of the Anglo-Argentine Pact were attempted in negotiations between Indian and British businessmen. The objective was said to have been that of enabling India to service her external debts while ensuring an expanding British presence in the Indian market, especially for cotton textiles.[8] Despite the above agreement, through the early years of the depression, London's policy was to coax, cajole and finally threaten the Government of India into adopting policies that would safeguard the chief metropolitan interest in its financial relationship with her colony.

The source of this interest has already been anticipated in the earlier chapters and forms the second of the two constraints referred to in the opening sentence of this section. If liquidity constraints at the centre affected the extent to which India could draw gold on her monetary and non-monetary account in the 1920s, the same considerations prevailed in seeking to ensure that India would promptly fulfil her short and long-term sterling obligations. At a time of weakness in her current account position, and at a time when the true size of Britain's short-term indebtedness in relation to her liquid assets were becoming privately and publicly evident, the importance of transfers from India for the British balance of payments and for the precarious stability of the sterling on the gold standard could hardly be exaggerated.[9] To the extent that exchange-rate depreciation was seen by Whitehall to hinder rather than help the discharge of Indian current account obligations, the

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8 For a discussion of the Lees-Mody Pact, see B.Chatterji, "Business and Politics in the 1930s : Lancashire and the Making of the Indo-British Trade Agreement", **MAS**, Vol.15, No.3, 1981.

9 In discussing the British current account position in 1931, the Treasury felt that there was no room for defaults. The estimates allowed "only a small reduction in our receipts from our fixed-interest foreign securities .... Defaults are already commencing to occur in South America, and a large reduction in our receipts under this head is to be expected in 1932 ..." especially as loans from London were suspended. See PRO T172/1756, "The Balance of Payments", unsigned Treasury memorandum, undated but written in the summer of 1931.

former instrument was unusable. The need to defend what turned out, by common admission, to be an over-valued parity only accentuated the transfer of resources from the periphery to the centre. Some of this transfer would have taken place in any case - as the Latin American experience of the 1980s showed - but greater freedom of policy may have reduced the size of the transfer and enabled them to have taken place with fewer deflationary results for India.

A dramatic outcome of the rupee and sterling leaving gold in September 1931 was the surge in Indian gold exports that resulted. Again, some gold exports would have taken place from India anyway, but the absence of policies to mitigate the impact of the depression on producers' incomes ensured a constant outflow of gold from hoards. These gold exports were the logical sequel to a policy designed to avert Indian gold demands in the relatively expansionary conditions of the 1920s. When the world went into a slump in the 1930s, India became an exporter of gold, and an expansionary influence on the world economy. Thus, India fulfilled Keynes' prescription of her role in the international system and his prophecy. But they were both results, not of a spontaneous Indian response to the economic currents of the two periods, but, of largely policy-induced events. The policy and its motivations during the 1920s have been examined in the two previous chapters. In this section and the next, we attempt to place policy in the depression years in this evolving framework.

The first part of this section discusses the multilateral constraints facing Britain within which Indian financial policy needs to be situated. The second part discusses the manner in which the former impinged on India.

VI.2.A BRITAIN'S LIQUIDITY CRISIS

As we have seen in the earlier chapter, Britain looked to the United States to support international expansion by keeping her domestic interest rates low and sustaining her capital exports. In the ten years following the end of the First World War, the United States emerged as a major international creditor. In 1914, Britain's foreign assets roughly equalled the combined overseas assets of the other creditors and the USA itself was a net long-term debtor. In the 1920s however, the USA outstripped Britain as an overseas lender as Table **VI.4** below shows.

Britain's ability to lend abroad was severely affected by her current account position. But her continued lending depended to a certain extent on attracting short-term capital especially from the other European markets. But it produced the inevitable mis-match between short-term liabilities and long-term assets that lay at the heart of the collapse of sterling on the restored gold standard in September 1931.[10]

Moreover, the bulk of the British investments abroad went to the Empire.[11] By 1931, the latter accounted for about 59% of all British investments abroad as against 47% in 1913.[12]

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[10] D.E.Moggridge, **British Monetary Policy**, 1972, p.200.

[11] Royal Institute of International Affairs, **The Problem of Foreign Investment**, London, 1937, quoted in B.Eichengreen and Richard Portes in Richard Portes and Alexander Swoboda eds., **Threats**, 1987, p.15.

[12] D.H.Aldcroft, **From Versailles**, 1977, p.242. Australia, New Zealand, India and Ceylon received the lion's share of the new investments, while Canada and South Africa declined in importance. In the Indian case, apart from the debts contracted between 1921/22 and 1923/24 in order to secure an appreciation of the rupee, a portion of the sterling loans raised between 1927/28 and 1931/32 was to support an over-valued rupee. See E.S.Pressnell, "1925", **EHR**, 1978, pp.82-83.

There were two reasons why British lending activity in this period was focused on the Empire. The concern to keep the Empire free of American influence was one. Secondly, a larger share of the Empire's borrowing was spent normally in London, though again, this differed from country to country and the Treasury itself was not convinced that loans to the Empire created any new business. Some types of lending such as the ones to India however did not have a direct adverse effect on the British balance of payments. The bulk of the Indian borrowing was spent in London. Besides, the total sterling expenditure of the Indian government consistently exceeded her sterling debts in this period. Further, in every year between 1924/25 and 1929/30 the capital expenditure on railways alone of the

TABLE VI.4 FOREIGN CAPITAL ISSUES : 1920-1931

Period	New York	London
1920-23	531	416
1924-28	1142	587
1929-31	595	399

[All figures in dollar million. Source: United Nations, **International Capital Movements in the Inter-War Period,** Washington, 1949, p.25, quoted in Albert Fishlow, "Lessons from the Past : Capital Markets during the 19th Century and the Inter-War Period", in Miles Kahler ed., **The Politics of International Debt**, Ithaca, 1986, p.72.]

American lending abroad began to slow down in the second half of 1928. After reaching its highest levels at $1050 million in the first half of 1928, it declined to about $450 million each in the second half of 1928 and the first half of 1929. In the second half of 1929, it fell further to $229 million. The US gold stock that had declined through 1927 began to rise again in the last six months of 1928 and through 1929.[13] According to the Macmillan Committee, the gold holdings of the "creditor countries" (Britain, France, USA, Belgium, Holland, Switzerland and Sweden) as proportion of the total world monetary gold holdings increased by five percentage points each year in 1929 and 1930. At the end of 1930 they held three-quarters of the total monetary gold stock.[14] But the only countries that gained gold in this period were USA and France - the former having gained in 1930 alone, almost half of Europe's gold gains over 1925-1928.[15] Europe in particular was severely affected by the decline in US lending. In 1929, US lending to Europe was less than a quarter of its levels in 1928, as compared to 80% to the other regions (and 50% if Canada is excluded).[16]

Apart from the decline in US lending abroad, her own domestic down-turn in the summer of 1929 affected demand for the exports of primary producers and their prices.[17] With falling receipts from abroad, primary producers began to default on

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Government of India exceeded the sterling debt contracted by it. If one considers only the net borrowing (that is net of repayments) the above generalization holds for 1931/32 as well. See IOLR L/F/6/1191/F.2784, "Statistical Note on Indian Finance".

13 L.V.Chandler, **American Monetary Policy**, 1971, p.35.

14 Macmillan Committee, **Report**, 1931, para 311.

15 Macmillan Committee, **Report**, paras 140-143. French and US gold gains in 1930 taken together equalled Europe's gold gains over 1925-1928.

16 B.Eichengreen and R.Portes in R.Portes and A.Swoboda eds., **Threats**, 1987, p.15.

17 According to Fearon, between 1929 and 1932, US imports of goods and services and export of capital fell from $7400 million to $2400 million. See P.Fearon, **The Nature and Origins of the Great Slump**, London, 1971, p.51.

their external obligations from January 1931. The growing threat of debtors defaults created uncertainty in the market for long-term loans. Inevitably, the short-term capital market also suffered. There was a spate of short-term debt liquidation which, in the absence of a lender of the last resort in the international banking system, began to severely affect the domestic banking systems of Eastern and Central Europe. In this unstable climate, the inability of British investors to withdraw from Austria and Germany and the Macmillan Committee's disclosure of the size of Britain's short-term obligations led to a run on the sterling which culminated in the sterling going off gold in September 1931.[18]

The cessation of American lending was not the only factor in the sterling crisis. Beginning in 1929, France began to liquidate her large holdings of short-term sterling paper and repatriate them home in the form of gold. This movement must also have been accelerated by the unsettled conditions in the international markets.

Between January 1929 and June 1929, 21% (or 55 million pounds) of official French foreign exchange assets were liquidated.[19] Although, following protests by London authorities, the Bank of France ceased liquidating its sterling holdings after June 1929, the French share of global monetary gold reserves increased from 8% in 1926 to 13% in 1928, 16% in 1929, 19% in 1930 and 24% by the end of 1931.[20] Thus while official French foreign exchange assets did not decline over June 1929 - June 1931, her gold reserves increased by more than half in this period, from 293 million

[18] On the significance of the failure of the **Credit Anstalt** see J.M.Atkin, **British Overseas Investment, 1918-1831**, New York, 1977, p.290.

[19] Judith Kooker, "French Financial Diplomacy", in Benjamin Rowlands ed., **Balance of Power or Hegemony?**, 1976, p.106.

[20] Judith Kooker, "French Financial Diplomacy", in Benjamin Rowlands ed. **Balance of Power**, p.103. B.Eichengreen, "International Policy Coordination, in W.Buiter and R.Marston ed., **International Coordination**, 1985, p.145 says between 1928 and 1932 the Bank of France "engaged persistently" in converting her sterling balances into gold. This is received wisdom on the collapse of the gold standard in 1931 but is of doubtful validity.

pounds to 451 million pounds. By June 1932 it had increased to 657 million pounds.[21] Partly, this reflected the return to France of speculative capital transfers previously made by the French private sector. Secondly, the inelastic nature of the French banking system, deriving from limitations on the right of the Bank of France to expand domestic credit against securities, compelled French commercial banks to repatriate their foreign balances which had largely been in the form of sterling.

The unsettled short-term markets affected the Bank of England's gold reserve. The latter fell from about 163 million pounds in 1928 to less than 147 pounds million in 1929. It rose to 155 million pounds in 1930, as some countries on the periphery (Spain, Argentina, Brazil and Australia) began to lose gold. In 1928 and 1929, the Bank of England was able to buy about 50% of the gold sold in London. In 1930, it could buy only 1.41 million pounds out of the 44 million pounds sold.[22]

The financial authorities in London could not be indifferent to the consequences of the French gold drain. They saw that if London was to remain a free gold market, Britain had little option but meet the French gold demand.[23] However, the Treasury wished devoutly that the French would reform their banking system to make domestic expansion less dependent on gold.[24] As Leith-Ross wrote to Waley in Paris, though London was willing to supply gold, "the situation here over

[21] Judith Kooker, "French Financial Diplomacy", in Benjamin Rowlands ed., **Balance of Power**, p.106.

[22] Macmillan Committee, **Report**, Paras 165-66.

[23] Montagu Norman refused, in 1930, to intercede with the Governor of the Bank of France because it would reflect badly upon the prestige of the Bank of England and perhaps alarm the French into withdrawing their official sterling holdings as well. But earlier in 1929, Norman had appealed to Moreau to desist from draining gold from London. The appeal did not work but this was soon followed by threats, which did. See A.Boyle, **Montagu Norman**, 1967, p.**153**.

[24] See PRO T160/430, F.12317/1, Note by Leith-Ross for Hopkins dated 17 November 1930.

unemployment and prices is so acute ... that we cannot be indifferent to operations which have the indirect effect of putting a further strain on the market."[25]

Until 1930, the gold shortage school had been on the fringes of the policy making apparatus. But now, the refrain that the short-term maldistribution of gold was the chief cause of the depression began to be heard even from the British Treasury. Hopkins noted that the "general problem of prices, apart from the drop following the US slump, is mainly a world central banking problem. An aggregate standard (sic) of gold reserves in excess of gold supply means a perpetual inconclusive struggle for more gold in each country. US and France from different angles have especially acquired more than their share. The British (reserve) ... is an extremely moderate sum given population and wealth and international market."[26]

In its report, the Macmillan Committee gave the short-term gold shortage hypothesis the respectability of its official endorsement. The committee attributed the depression to the illiquidity of the world economy, which in turn it attributed to the shift in "international lending power" away from Britain and towards the USA

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[25] PRO T160/430, F.12317/1, Leith-Ross to Waley, letter dated 30 May 1930. The Treasury was therefore keen to prevent the deflationary effects of French gold demands. It hoped to meet a part of the French demand by liquidating a dollar reserve of $50 million accumulated by the Bank of England in December 1926 to sterilize "haphazard" gold offerings to it. Should it be needed, the Treasury wanted a long-term loan floated in the USA. If the Governor liked neither option, the Treasury felt, he should be told that the French gold withdrawals should not be allowed to curtail domestic credit. See PRO T160/430 F.12317/1, Leith-Ross' note for Hopkins and Chancellor of the Exchequer dated 17 November 1930 and Henry Clay, **Lord Norman**, 1957, pp.254-55.

[26] PRO T170/46, "Gold Standard and Rationalization : Notes", undated by Hopkins for the Macmillan Committee. Hawtrey, also attributed the depression to the "scramble for gold". See PRO T160/430, F.12317/1, Hawtrey to Hopkins, letter dated 10 December 1930. For similar views, see Royal Institute of International Affairs, **The International Gold Problem**, London, 1931, p.93, Henry Clay, **Lord Norman**, 1957, p.246 and Montagu Norman's testimony to the Macmillan Committee. I.M.Drummond, **The Floating Pound**, 1981, pp.128-33 discusses the background to the gold-shortage hypothesis and its influence on the British policy-makers.

and France.[27] At other places, the report was more explicit in its endorsement of this view.[28]

The problem facing Britain in 1930 and 1931 was two-fold. The first was the mis-match between Britain's liquid and short-term liabilities and assets. Before the First World War, it has now passed into received wisdom, the Bank of England's gold reserves and sterling acceptances on foreign account were "as a rule at least equal or in excess" of British short-term liabilities.[29] By 1930, Britain was a large short-term debtor. Her known short term assets included 153 million pounds in acceptances on foreign account and an equivalent amount of gold in the Bank of England. Her short term liabilities at 407 million pounds (including sterling bills and short-term deposits in British banks in London) made her a net short term debtor of the order of about 100 million pounds. Although the Macmillan Committee (para.259) found this position reassuring, if sterling bills and short-term deposits of 350 million pounds held by foreign banks are included, the British short-term position is seen to deteriorate alarmingly. Some of the official sterling holdings of the Empire countries (about 150 million pounds) would not have been withdrawn in the normal course, but, as their currencies came under strain and London's loans to them declined, they began to liquidate their sterling holdings. With a flight of capital from the sterling area, the drain of liquid resources from Britain became accentuated. Nor was an early end to the drain in sight. By 1930, the sterling assets of the Bank of France alone roughly matched the Bank of England's gold

27 Macmillan Committee, **Report**, para.240

28 Macmillan Committee, **Report**, paras 185 and 140-150. The committee said, given goodwill and central bank cooperation, the problem of gold distribution was not beyond solution. But as we have suggested in Chapter **I.4**, in the climate of the times, central bank cooperation was not easily achieved despite the desires of the British central bank and the Treasury.

29 Macmillan Committee, **Report**, para.351. A.Bloomfield, **Monetary Policy under the International Gold Standard, 1880-1914**, New York, 1959, p.42, disagrees and suggests that, even before 1914, Britain's liquid and short-term assets may not have consistently exceeded her liquid and short-term liabilities.

reserve.[30]

The second problem, which is a related one, has been discussed in the introductory chapter. This was the limitation of the bank rate as an instrument of monetary policy, which was becoming more evident in this period. Firstly, there was growing domestic opposition to its use to defend the gold reserves of the Bank of England. Treasury officials were not insensitive to this sentiment. Despite attempts to prevent gold withdrawals affecting domestic credit, the former were proving deflationary. In an already depressed economy, this was a source of political opposition. When the French suggested to the British Treasury that they put up their bank rates to stem gold outflows, Treasury officials rejected the advice.[31] Later the same year, when the failure of the Austrian **Credit Anstalt** revived a run on the Bank's gold reserves, it sought and obtained, over the objections of some Treasury officials, the authority to increase the bank rate from 2.5% to 3.5% on 23 July 1931 and 4.5% a week later. Recording his opposition to the increase, which he feared was worsening the depression, Hawtrey said that it would not induce foreigners to keep their balances in London, unless they were official sterling exchange reserves or working balances. Speculative short-term capital transfers, he implied, could no longer be stemmed after a point, through increases in the bank rate.[32] The Macmillan Committee noted that a higher bank rate served to increase Britain's short-term liabilities, as the instrument worked as much to attract hot money from abroad as it worked by calling in short-term assets.[33]

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[30] See **Report** of the Macmillan Committee, p.301 and paras.351-52; Robert Triffin, **Gold**, 1960, p.66, A.Cairncross and B.Eichengreen, **Sterling in Decline**, pp.51-52 and Eichengreen in Buiter, W. and Marston, R., eds., **International Policy**, 1985, p.145.

[31] PRO T160/430 F.1317/2, "Gold Movements : Points for Discussion with the French Treasury", memorandum by Leith-Ross dated 12 February 1931.

[32] CCA Hawtrey Papers, Htry 1/47, "Bank Rate and the Crisis", memorandum by Hawtrey dated 1 August 1931.

[33] **Report** of the Macmillan Committee, para.351.

It was in this environment of declining current account balances for Britain, a general decline in overseas lending, growing indebtedness on the short-term account, a drain on British short-term and liquid assets and an ineffectual bank rate that the Indian economy was required to finance a shift of resources to the centre and in order to secure this shift, subject to severe deflation.

VI.2.B INDIA : CONSTRAINTS AND RESPONSE

The main financial problem facing the Indian authorities between the winter of 1929 and the autumn of 1931 was the outflow of short-term capital, discussed above. The principal reason for this haemorrhage was that, as the depression began to affect trade, surplus funds that were no longer required to finance Indian trade were being exported abroad.[34] This phenomenon was not peculiar to India. The official Indian government explanation was that the Civil Disobedience Movement of the Congress Party and the prospect of a transfer of financial responsibility to an Indian Minister of Finance caused these outflows and the consequent weakness of the rupee.[35] This explanation has been echoed by later scholars.[36] But it is

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[34] IOLR L/F/5/189, S.F.Stewart to Lord Chancellor, letter dated 21 August 1931, para 5.

[35] See IOLR L/F/7/474, F.22, Colln.43, Viceroy to Secretary of State, telegram dated 9 May 1931 and 10 May 1931. The Indian government sought a drawing credit of 50 million pounds initially (later raised to 100 million pounds), as a means of reassuring markets while constitutional reforms were under way in India. The request was rejected by the British cabinet acting on the advice of the Treasury. The Government of India had to be satisfied by an assurance by the British Prime Minister that British parliamentary safeguards would hedge the transfer of financial powers to a responsible government in India. The price of this guarantee (as it later came to be called) was yet more rigorous deflation in India, this time under the supervision of a rigid Treasury. The file on the Government of India request and the subsequent response is PRO T160/400, F.12471/03/1-2; also see IOLR L/F/6/1177/F.3693.

[36] See for example, B.R.Tomlinson, "Britain and the Indian Currency Crisis-1930-32", **EHR**, Vol.32, No.1, 1979, pp.88-106. Also see I.M.Drummond, **The Floating Pound**, 1981, pp.28-51. Drummond (pp.44-45) briefly considers the possibility that the short-term outflows from India in this period may have been leaving the sterling area.

necessary to look at the official Indian government explanation more closely.

The political instability explanation for short-term capital outflows is unsatisfactory. These outflows were confined to the years when there was a pressure on the sterling. If fear of political reforms explained short-term transfers in 1931, there is no reason why the latter should have been relatively steady in 1935, when the reforms were actually implemented. Secondly, Britain's capital account was much stronger in 1935 than in 1931 and a smaller inducement would have been required to shift funds from India to Britain.[37] As we discuss later, it is also significant that the small amounts of gold that India exported in January 1931 went directly to Paris and not to London.

The most likely reason (apart from their redundancy in the depressed trading conditions) for short-term funds leaving India seems to have been the desire to withdraw funds from the sterling area. Sterling was strong in relation to the rupee but as it weakened in relation to the dollar and European currencies, the tendency to flee the sterling area may also have affected rupee holders. This was the

[37] New Delhi may have advanced this explanation for capital outflows from India because it did not have the stomach meet the demand for accelerated contraction from the India Office and the Bank of England. See for example IOLR L/F/6/1175, F.2222, Viceroy to Secretary of State, telegram dated 12 May 1931 and L/F/7/474, Viceroy to Secretary of State, telegram dated 9 May and 10 May 1931. The Indian government claimed to be tackling the crisis "more directly and courageously" than the British government. Contraction had been severe. Indian "money rates" were higher than in other parts of the world and at a level sufficient to attract foreign funds "if only ordinary financial factors were at work." There were limits to how far the bank rates could be raised, as other reactions to this policy needed to be taken into account. The latter included the depression, which was "already the most serious factor in the Indian situation ...." The bank rate, it said, was proving both costly and ineffective and in the situation that existed, capital outflows could not be tackled through financial measures alone. The Indian government might have expected that political reform was a powerful argument to secure standby credit to underwrite reforms while stabilizing the rupee. This argument suited Whitehall because it could be used to restrict the extent to which financial powers were transferred to Delhi! It is interesting that there is no evidence in the India Office records to suggest that officials ever considered, even in passing, that the drain of short-term balances from London might have some bearing on the Indian capital account position.

suspicion of the General Manager of the Imperial Bank of India, Osborne Smith who later became the first Governor of the Reserve Bank of India.[38] By August 1931, it was clear that even British firms were leaving sterling for "dollars, francs and guilders."[39] Short-term fund outflows from India had resumed and the Imperial Bank of India confirmed that London was the main source of weakness for the rupee.[40]

The probability that, when the sterling was weak in relation to the dollar or any other major currency, there would be a drain on Indian reserves had been foreseen as early as 1925. Discussing the external convertibility obligation of the Indian currency authorities in the gold bullion standard proposed by the Hilton-Young Commission, Hawtrey had remarked that, were the obligation to take the form of gold, a part of the demand for gold in London would be transferred to India if the sterling were at specie export point at some centre and the rupee was below par with respect to the sterling.[41] The crisis of 1930-1931 resembled Hawtrey's hypothesis. Though India was not obliged to sell gold, the weakness of the sterling in New York and in the European markets might still have led to an outflow of funds from India as rupee holders sought to move out of sterling. The sterling weakness explanation for short-term capital outflows from India is supported also by the fact that the demand for reverses stopped almost immediately as the sterling left the gold standard. If speculators (or rupee holders) had been nervous about rupee stability, the depreciation of the sterling and the absence of a rupee

[38] See NMMA PT Papers, File 105, Osborne Smith to Purushottamdas Thakurdas, letter dated 20 November 1930.

[39] PRO PREM 1/97, Reading to Prime Minister, letter dated 10 September 1931. Also see Robert W.D.Boyce, **British Capitalism**, 1987, p.340

[40] IOLR L/F/6/1180, F.606, Viceroy to Secretary of State, telegram dated 16 September 1931.

[41] CCA Hawtrey Papers, Htry 1/3/2, Hawtrey to Blackett, letter dated 16 October 1925.

depreciation would have tempted them to leave the rupee in the expectation that it would follow the path shown by the "mother currency".[42]

As capital outflows grew and the weak rupee ruled out sterling remittances, the Indian monetary authorities could have imposed restrictions on short-term capital outflows as some Latin American countries did. But there is no evidence that the Indian government proposed the measure before September 1931 or of the India Office even considering it.[43] In the absence of capital controls, the monetary authorities could either augment reserves by borrowing abroad or enforce domestic contraction in India. There was a third option which could have been used together with the above, that of devaluation. But for reasons that we discuss later, London dismissed this option out of hand. As the chances of borrowing in London diminished either because of her inability to lend or the unreceptiveness of the market to Indian loans, the need to adopt contractionary policies in India deepened.[44]

From time to time, as we have suggested in an earlier footnote, the Bank of England continued to press the India Office to secure adequate monetary contraction

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[42] This was the South African experience. See Leo Katzen, **Gold and the South African Economy**, Amsterdam, 1964, p.84.

[43] The Whitehall bureaucracy might have thought that controls of this nature in India would have sent strong signals to the financial markets about London's own policy preferences when faced with a gold drain. But as we see later, even when the Indian government unilaterally imposed capital controls after the sterling left gold, the India Office wanted them lifted, although the British government itself had imposed checks on short-term outflows. In January when Delhi wanted to lift the remaining controls, the Treasury opposed it because it thought Indian gold exports would be checked! Thus, policy on Indian short-term outflows in these months may have paid greater attention to British liquidity needs than to its effects on the Indian economy.

[44] IOLR L/F/6/1175 F.2222, Secretary of State to Government of India, telegram of 18 April 1931 said the Deputy Governor of the Bank of England stressed the "difficulty of financing India by loans on this side" and enquired about contractionary measures taken to reduce "appeals to the London market." An early draft said, the Deputy Governor had "spontaneously raised (the) question".

in India and fight bear pressures on the rupee. In a meeting held in May 1931, the Governor took a "most serious view" of the outlook for India. He ruled out the chances of a medium-term loan and apprehended that before long, gold would need to be shipped out of India or sold in India against sterling. Before more loans could be floated, the rupee needed to be brought up to parity and in order to do this, it was necessary to "produce money famine to frighten the bears of exchange and to induce a demand for rupees."[45]

The India Office quest for contraction began as early as September 1929. During the winter of 1929, throughout 1930 and till September 1931, the Indian government contracted substantial volumes of currency in circulation. The Paper Currency Reserve fell from Rs.1867 million in September 1929 to Rs.1487 million in September 1931 - a fall of just over 20% in two years (Table **VI.5**). The bulk of the contraction in 1929/30 and 1930/31 took place in the peak season. Between September 1929 and March 1930, gross coin and note circulation fell from Rs.1866 million to Rs.1772 million and between September 1930 and February 1931, from Rs.1715 million to Rs.1565 million.[46] By November 1930, the Imperial Bank - the closest thing that India had to a central bank at this time - found Whitehall's demands for contraction, unsustainable.[47] The India Office sought an increase in the Treasury bill rate so that the Government of India could draw currency from the market and be "in a position to effect further real contraction as required."[48]

[45] IOLR L/F/7/474 F.22, Secretary of State to Viceroy, telegram dated 28 April 1931. The Governor reiterated these views barely a week later. See IOLR L/F/6/1177 F.3693, Norman to Kisch, letter dated 5 May 1931.

[46] All currency figures from statements in Government of India, Finance Department, **Reports of the Controller of Currency**, New Delhi, appropriate years. See IOLR V/24/3442-3452.

[47] NMMA PT Papers, Osborne Smith to Purushottamdas Thakurdas, letter dated 27 November 1930. Osborne Smith also said support to the 18d. rupee was proving "expensive". See his letter to Thakurdas dated 16 January 1931.

[48] IOLR L/F/7/897, Colln.107, Secretary of State to Viceroy, telegram dated 4 December 1930.

TABLE VI.5 GROSS COIN AND NOTE CIRCULATION : QUARTERLY, 1929 - 1934

Year	March	June	September	December
1929		1877	1866	1794
1930	1772	1637	1715	1613
1931	1608	1525	1487	1793
1932	1781	1708	1757	1748
1933	1769	1765	1797	1781
1934	1772	1808	1851	1839

All figures rounded off to the nearest Rs.million.

Source: Government of India, Finance Department, **Report of the Controller of Currency**, New Delhi, different years.

The weighted average of the Indian bank rate in 1930 and 1931 was about 7% (with a high of 8% and a low of 5%) while that of the bank rate in London was under 4 per cent.[49]

However there were three further problems. Firstly, as the Paper Currency Reserve was contracted, the reserves were transferred to the Gold Standard Reserve in India. Meanwhile, with increasing sales of sterling in London, the Gold Standard Reserve there was being depleted and the question arose of making transfers from the reserves in India to the reserves in London. Secondly, the depression was forcing Indian cultivators to sell their gold holdings to settle fixed debts or finance consumption. But as these gold hoards were sold to the government, they were an expansionary influence. Almost the entire expansion in February and June 1931 is to be explained by gold sales to the Government of India by the Indian public. The depletion of London balances and the accumulation of gold in the reserves in India led to the India Office and the Bank of England urging the government in Delhi to export gold to London. These exchanges are discussed in the next section.

The third problem was that the Indian banking system was poorly developed and there were many hindrances to the operation of monetary policy instruments, especially if the Government of India was a borrower in the market for short-term funds. Firstly, any increase in the bank rate would push up the borrowing costs of the Government of India. Secondly, it lowered the price of government securities in the market and interfered with its loans programme. Lastly, the Imperial Bank of India, who were also the bankers to the government, were in the habit of discounting Treasury bills as a means of lending short-term funds to the market. As the government increased its short-term borrowing, funds absorbed by the government came back into the market through the discounting of these bills. The

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49 IOLR L/F/5/101-102, Financial Department Statistics, p.73 and p.21.

more the government discouraged lending against these bills, the less attractive these bills would become to the investor.

But the depression was also affecting the government's budgetary position. Actual revenues fell short of estimates by over Rs.110 million in 1930/31 while actual expenditure outstripped estimates by about Rs.15 million. As a result, the years accounts, which were balanced in the budget estimates, yielded a deficit of Rs.115 million. Although, duties on cotton cloth, raw cotton, textile machinery and salt and the income tax were increased in the 1931/32 budget and in an emergency budget in September 1931, actual revenues fell short of the original estimates by over Rs.125 million. Despite cuts in expenditure, actual expenditure exceeded the September 1931 estimates by about Rs.3 million, yielding a deficit of about Rs.115 million pounds in the 1931/32 financial year.[50]

The pressure on the rupee, the reserve losses arising from the need to defend it and the domestic contraction that it entailed, brought to the fore the question of the equilibrium parity for the rupee. Indian politicians and businessmen resumed

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[50] See **East India Finance and Accounts**, Cmd.4416, 3670, 3969, 4161, HMSO, London, various years. The aim of the increase in the salt tax was to "call upon" the "... great mass of Indian populace ... to take their proper part in the rehabilitation ...." of the finances of the Government of India. IOLR L/F/6/1180 F.5952, "Note of Qualification by Mr.Kisch" dated 16 September 1931, attached to the Secretary of State to Viceroy, telegram dated 17 September 1931. The discussions on budget proposals are in the above file and in L/F/6/1173 F.392, L/F/6/1174 F.2134 and L/F/6/1188 F.462. The latter has an interesting exchange between Delhi and London on excise and import duties. Kerosene was produced in India by British firms while the imports came mostly from American and Dutch owned oil-fields. In its 1931/32 budget proposals, Delhi proposed equalizing the excise and import duties on kerosene at the higher level of the latter. But the India Office, which had been pressing for such an equalization in the case of cotton cloth (an important Indian import from Britain which competed with the output of Indian-owned firms) opposed the move in the case of kerosene! See Viceroy to Secretary of State, telegram dated 18 March 1931 and the latter's reply of the same date. Also see Turner's undated minute in the same file.

Despite the impositions of the depression years the sources of government revenue did not change greatly in their importance over 1927/28 - 1936/37. Custom receipts yielded between 22% and 25% of total revenues, land revenue between 14.5% and 16% and excise duties between 7.5% and 9%.

agitating for a 16d. rupee. The India Office was consistently and resolutely opposed to any plea for a rupee devaluation and its views may be considered briefly.

The exchange rate controversy revived at the same time as a projected Round Table Conference to discuss political and constitutional reforms for India. The India Office found itself in a dilemma because any explicit refusal to reconsider the parity might scupper the chances for a political settlement. On the other hand, the absence of such a statement, the India Office seemed to feel, would send the wrong signals to the market. Secondly, at this time, a Labour Government, with a more open commitment to constitutional reforms in India, was in office. Apart from his own personal commitment to reforms, Wedgwood-Benn, the Secretary of State for India, was not convinced that the cost of preserving the 18d. rupee was justified by its advantages. This conflict between the Minister and his advisers increased the shrillness in the tone of the memoranda prepared by the latter. But in the end, the Secretary of State caved in and circulated a note by Kisch, on the dangers of an Indian devaluation, to the Round Table Conference.[51]

Kisch's note acknowledged that the currency system had been exposed to heavy strain owing to falling prices. He conceded that the "gold reserves of Government (had) been heavily drawn on since 1926 and the position (had) only been maintained by constant watchfulness in the control of the currency and heavy borrowing". The continued instability of the rupee since 1926 pointed, not to the need to reconsider its parity, but, to the need to ensure that "confidence in the permanence of the established gold ratio should be restored." In other words, Kisch hoped to ensure that a rupee parity that had not been stable in the relatively buoyant trading

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51 Kisch's note "The Exchange Question" dated 24 November 1930 is in IOLR L/F/5/189; Wedgwood-Benn circulated Kisch's above note along with his own memorandum dated 25 November 1930. Wedgwood-Benn had believed apparently that the British Treasury imposed the 18d. rate on India in 1926. See D.Rothermund, **An Economic History**, 1988, p.103.

conditions of 1926-1928 should be rendered finally permanent in the depressed conditions of 1930/31.

There was no need to change the rupee parity, Kisch argued, because Indian prices had generally moved with world prices. If the Hilton-Young Commission thought 18d. represented equilibrium prices, he suggested, "it must be presumed that this view holds still more today." Then Kisch resorted to rhetoric to support his case. A time of falling prices was one of stress. Adjustment of costs (especially wage costs) took time but the fixed parity experience of the leading countries "which have fought hard to maintain their exchanges" suggested that there was no short-cut to adjustment "by an abandonment of ... exchange ratings".[52] The strenuousness of the adjustment process cannot be eased, the memorandum insisted.

Before long, however, in the same memorandum, Kisch contradicted himself. Having just argued that Indian and world prices had fallen together, he then went on to say that the "period of declining prices" had been "particularly severe in the case of raw materials and agricultural produce" which India exported.[53]

Kisch pointed out that a devaluation would increase the rupee counterpart of the sterling expenditure of the Government of India. The latter might also have to increase salaries paid to its employees, as real wages, especially of employees who consumed imports, he specified explicitly, fell. Railway tariffs might have to be raised as well. Government revenue was inelastic and additional revenue would be

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52 All references are to Kisch's memorandum, "The Exchange Question" dated 24 November 1930 in IOLR L/F/5/189. Note that even after Britain and other major countries ceased to "(fight) hard to maintain their exchanges", India Office views on a rupee devaluation did not change.

53 IOLR L/F/5/189, Kisch's memorandum dated 24 November 1930. See also PRO T160/519, F12471/05/4, "Indian Balance of Payments", memorandum by Hawtrey dated 9 August 1933. Hawtrey felt that the 18d. rupee corresponded to 2s. at 1933 prices.

needed. "The stress of readjustment will be very great ...."

All producers and manufacturers tended to be "inflationist" and devaluation, the memorandum asserted, was only a form of inflation. The exporter gained till wages adjusted and in the short-term, exports could be stimulated. Taken as a whole, there were no benefits as the extra incomes from exports was offset by an extra outflow on imports.

Thirdly, a devaluation would "penalize" all those to whom fixed debts were owed and lenders would suffer. The gains to the producers were temporary and would be obtained at the cost of "every holder of the rupee". "There was no doubt" Kisch insinuated "that the demand for a reduction of the rupee is based on the hope of the industrialist to obtain a benefit at the expense of those to whom he is obliged to make payments fixed in rupees ...." He then went on to ask rhetorically, why should devaluation stop at 16d.? Why should it not be taken further?[54]

Just such an apocalyptic scenario was the subject of another memorandum by Kisch a few months later. Samuel Hoare, the new Secretary of State in the National Government, wanted a note giving a "concrete picture" of what would happen "(i) in India, to the small cultivator ... business etc. if there was a **complete break** in Indian credit and if the rupee was **unpegged** and **ran down uncontrolled**, (2) in Great Britain with our big holdings of Indian securities." Hoare wanted a "picturesque brief".[55] The memorandum that Kisch prepared in response to this request bears detailed quotation.[56]

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54 All references above have been to "The Exchange Question", memorandum by Kisch dated 24 November 1930.

55 IOLR L/F/6/1183 F.6444, note by Hoare dated 30 August 1931. The emphases are mine to underline the assumptions inherent in the note.

56 See IOLR L/F/6/1183 F.6444, "The Effect on the Indian Economy and Credit of a Collapse of the Rupee Exchange", memorandum by Kisch dated 18 September 1931.

All contractual obligations were in the form of money in modern society. "Any break ... in the value of money" had greater effect than the break in other "social or economic conventions". Secondly, he asserted, if the rupee was not stable at 18d. it would not be stable at any other lower parity. With diminished reserves and with people getting out of rupees, the latter would crash to its bullion value of 4 $^1/_2$d.. This assumption therefore underlay Kisch's other arguments.

With an increase in counterpart rupee obligations of the Indian government, there would be a threat of default on the Government of India's sterling obligations unless the British government intervened. Budgetary equilibrium would be achieved only by increased taxation and by "permanently lowering the standard of administration". Salaries of government officials would have to be raised since many of them had liabilities in sterling. Savers would find their real savings greatly diminished. Wage-earners would be in a "sorry predicament". If their demand for more pay was not satisfied, "the peace of the countryside" would be threatened. (Kisch was referring to wages in agriculture). The depression in real wages during the adjustment period would benefit the manufacturer and exporter only.

To the extent that the peasants were indebted, the burden of their debts would fall. Their revenue burden would also fall. But the price of imports and other manufactures they consumed would go up. Further, the reduced debt burden of the peasantry "would be to the detriment of the whole creditor class, e.g., landlords, money-lenders, etc." and the "readjustment" involved would produce "extremes of hardship and injustice".

Further, as a result of a depreciation, Kisch said, India's exports would be stimulated and her imports curbed till wages rose. "International trade" would suffer a "profound shock" because of India's reduced purchasing power. The fall in the rupee would also lead to the cancellation of import contracts, besides severely affecting British exporters in other ways, he warned.

Holders of sterling securities of the Government of India, he said, "would be overwhelmed by anxiety" which would make British guarantees or credits indispensable. The repercussions of these events on British credit, he assured Hoare, would be "most unfortunate", especially at the "present time of uncertainty".

In conclusion, he said, the Indian experience revealed that "economic conditions ... are exceptionally sluggish in responding to changed circumstances, so that the painful period of adjustments would, in India, probably prove a protracted one."

These arguments, whether on the consequences for India of a depreciation or the postulated worst-case "rupee collapse" and the assumptions on which they were based are internally contradictory. They also clash with some of the assumptions and positions that the India Office adopted at other times.

The first assumption that comes into question is the one related to the degree of monetization of the Indian economy, especially its rural sector. The India Office's views on this subject seem to have undergone a considerable change between September 1931 and January 1933. In 1933, addressing the Monetary and Economic Conference of the League of Nations, Kisch approvingly quoted an Indian government estimate that the cultivator normally consumed about two-thirds of his output and sold only a third in the market. He used two-thirds of his revenue from the marketed surplus to discharge his fixed obligations to the government and the money lender. This left him only about 10% of his total output to buy consumer manufactures including imports and farm implements.[57]

It is evident that in Geneva, Kisch postulated a lower degree of monetization of the Indian economy than he did in his earlier memorandum opposing a rupee devaluation. In terms of the later model, no less than two-thirds of the output of the cultivator did not enter the market at all, being retained for own consumption and seed. In the event of prices rising in a devaluation, he would benefit with respect to two-thirds of his revenue from the marketed surplus : his fixed obligations to the government and the money lender. His losses would be confined to a third of his revenue from the marketed surplus and if we assume that prices of manufactures and agricultural products increased in the same proportion in response to a devaluation, then the latter actually leaves the cultivator better off.[58]

If Kisch's Geneva sketch of the Indian rural economy is accepted, it is no longer plausible to argue that a devaluation would be of benefit only to Bombay industrialists (and to the detriment of everyone else) or that the demand for a devaluation came only from these interests. Baker points to the growth of knowledge on currency questions in rural Tamilnadu during the depression and the hope of the agriculturalists that a rupee devaluation would help stabilize the prices

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57 IOLR L/F/6/1201 F.1291, League of Nations, Monetary and Economic Conference : Preparatory Commission of Experts, II Session, provisional minutes, III meeting, 10 January 1933, Geneva.

58 On the effects of exchange rate depreciation on purchasing power in the depression, see B.Eichengreen and J.Sachs, "Exchange Rates and Economic Recovery in the 1930s", **JEH**, Vol.45, No.4, 1985, pp.925-946. Findlater Stewart, a senior India Office official recognised that a rupee devaluation would increase purchasing power at least in the short-term. See IOLR L/F/5/189, Appendix, "The Ratio Controversy" in Stewart's letter to the Lord Chancellor dated 21 August 1931. But he said that the cultivator would be forced to concede higher wages to his labourers. This argument was also echoed by Kisch in his memorandum and represents a mechanical extrapolation of British industrial wage-bargaining methods and ideas of cost-push wage demands to Indian agriculture.

of their output.[59] At a meeting of Indian delegates to the Round Table Conference with officials of the Finance Department of the India Office, the former, who included representatives of agricultural interests, insisted that a devaluation would benefit the cultivator primarily. The India Office was unmoved.[60]

Another official ground for opposing devaluation was the increased rupee cost of the sterling obligations of the Government of India. We have already pointed out in an earlier chapter that this clashed with the neutral money assumptions normally used by the India Office to plead the ineffectiveness of exchange rate policy. Even were we to assume that the India Office's warnings regarding the budgetary effects of a devaluation were only confined to the short-term, still there is no explanation for why the argument continued to be advanced in 1934 and 1935 when the budgetary pressures of 1930 and 1931 had eased.[61]

The argument that a devaluation would increase the cost of government in India due to an increase in the salaries of government employees also merits some attention. In this context, it is instructive to recall the position of the India Office with regard to pay cuts of ICS officers in the 1931 emergency budget. When the Government of India suggested a 10% pay cut for ICS officers as an example of government economies, the India Office opposed the move. But, as the Indian government argued, the real wages of the ICS officers had increased in the

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[59] See C.J. Baker, "Colonial Rule and the Internal Economy in Twentieth Century Madras", **MAS**, Vol.15, No.3, 1981, p.578.

[60] See IOLR L/F/6/1183 F.6619, Meeting on Financial Questions of 16 October 1931, p.34. Another oddity in the official argument was the assumption that Indian cultivators hired wage labour. Indian delegates disagreed with this assumption. Further, the representative from Punjab also said that the entire wages of agricultural labour, where such labour was used, was paid in kind.

[61] Findlater Stewart conceded in a letter to the Lord Chancellor that a devaluation would not increase the real rupee cost of sterling obligations and that increased nominal rupee burden would be offset by increased revenue. See IOLR L/F/5/189, Appendix "The Ratio Controversy", in Stewart's letter dated 21 August 1931.

depression and a similar cut had been effected in Britain.[62] The India Office allowed the cuts to be made after it found the pressure from India irresistible, but extracted a promise that restoration of the cut would be the first charge on improved government revenues. In 1933 the India Office wanted the cuts restored and the revenue loss offset by an excise duty on matches.[63]

The third argument that needs to be examined is really less an argument than a tactic. The India Office seemed to take it for granted that if the rupee was not defensible at 18d. it would not be defensible at any lower parity. This assumption was valid in that the size and timing of the devaluation had a bearing on the stability of the new parity and that, markets needed to be reassured that no further devaluation was in prospect. What is mystifying is the India Office view that a devaluation, no matter how big, would increase the drain of capital from India rather than reduce it. Kisch pointed out that the rupee could collapse because of weakened reserves. But reserves were falling as a result of defending what, as even some Treasury officials had begun to recognize, was an overvalued parity. If it was decided to devalue and a firm decision announced to defend the new parity, there was no reason why the drain on reserves should continue, unless it was argued, as the India Office did not, that the drain of capital owed to factors outside India's control. The experience of 1925/26 showed for example that capital outflows that took place as a result of exchange rate uncertainty in the months preceding rupee stabilization at 18d. were reversed as soon as the uncertainty ended. The threat that Kisch held out of a free fall in the rupee was therefore an

[62] IOLR L/F/6/1180 F.5952, Secretary of State to Viceroy, telegram dated 24 September 1931.

[63] See IOLR L/F/6/1199 F.1, note by Secretary of State dated 12 January 1933. The note feared that pay cuts would reduce recruitment of British officers for the service. In reality, the depression had led to an increasing number of good quality applicants for military services in India. See "Notes by the Military Department" written by S.K.Brown and dated 11 January 1933 in the same file. There was no reason why the same would not have been true for the civilian services.

unrealistic one and merely served to compensate for the weakness of the exchange stability argument of the India Office.[64]

Lastly, we are left with the argument that Kisch advanced in regard to the sluggishness of economic adjustment in India. He seemed to argue that the process of adjustment of the Indian economy to the depression would be protracted and painful and that the stress was unavoidable. It might have been realistic to expect adjustment to an once-and-for-all exogenous shock. But at the time that Kisch was preparing his latter memorandum (August-September 1931), the depression had been in existence already for some months and there were no signs of revival. In the circumstances, an Indian devaluation would not have been "hyper-inflationary" as Kisch forecast, but would merely have insulated the Indian economy from the more severe effects of the depression. Therefore, the sluggish pace of Indian adjustment to the depression made a devaluation more, rather than less, necessary.

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[64] However, one must not ignore the self-fulfilling probability inherent in the free fall scenarios sketched by the India Office. Many persons in that office from the Secretary of State downward had contacts in the City and it is quite likely that their warnings might send powerful signals to the latter. See for example the **Times** of 24 September 1931 which echoed Kisch's views on the possibility of a free fall in the rupee.

VI.3 GOLD AND SILVER

When the sterling left the gold standard in September 1931, at the instance of the India Office and the Treasury and over the heads of the Government of India, the rupee was pegged to sterling at the old parity of 18d.[65] The move has evoked some comment.[66]

The Government of India was taken by surprise at Britain's abandonment of the gold standard. Whilst awaiting news from London (which the Finance Member of the Government of India, George Schuster thought was delayed in order to present him with a **fait accompli**) the Indian government announced drastic controls on capital outflows.[67] The India Office's own inclination was to keep India free of capital controls. In this, they had the support of the Treasury even though the latter had imposed some capital controls in Britain.[68] With controls already in place, the best that the India Office could do was to secure a replacement of the comprehensive controls imposed earlier, with new ones which - as in the British

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[65] IOLR L/F/7/474 F.22 Colln.43, L/F/6/1181 F.6195 and L/F/6/1180 F.6060. The collapse of the sterling in 1931 has been well-researched. A recent addition to this long list is Diane B.Kunz, **The Battle for Britain's Gold Standard in 1931**, London, 1987. Also see Robert W.D.Boyce, **British Capitalism**, 1987, pp.339-69.

[66] B.R.Tomlinson, **Political Economy**, 1979 and **EHR**, 1979, pp.88-106; I.M.Drummond, **The Floating Pound**, 1981, pp.41-43. The India Office saw its ability to move from a gold standard to a sterling standard without any change in the law as an "accident". See IOLR L/F/7/897, Colln.107, draft reply to a question by Mr.Wedgwood dated 27 November 1933. Tomlinson has echoed this view. But in terms of the evidence presented in the last chapter, it is not improbable that the India Office was aware of this possibility right at the outset. See especially IOLR V/26/302/8 Kisch's replies to the Hilton-Young Commission, Qns.11071-77, 11269-280 and Chapter **V.2** above.

[67] George Schuster, **Private Work and Public Causes : A Personal Record, 1881 - 1978**, Cambridge, 1979, pp.112-15.

[68] IOLR L/F/6/1181 F.6195, Secretary of State to Viceroy, telegram dated 20 September 1931.

case - allowed remittances for normal requirements.[69]

One outcome of the sterling's fall from parity was the premium that developed on gold, and the private exports of gold from India, that resulted. These exports provided Britain with vital room for manoeuvre both in the management of the sterling as well as in regulating her confrontation with the USA without great cost to herself.

Indian gold exports represented the liquidation, whether out of distress or for profit, of the gold hoards of the average Indian householder. As early as 1929, India had stopped competing for South African gold.[70] India's net gold imports fell steeply from Rs.212 million in 1928/29 to Rs.142 million in 1929/30. By 1930, before they imposed checks, many other primary producers in Latin America had also began to export gold.[71]

From the end of 1930, the Indian peasant began to fulfil Keynes' prophecy that he would dis-hoard gold in a depression or a famine. In January 1931, an estimated 1600 ounces of gold - "mostly in the form of jewellery" - was already arriving every day in Bombay from the upcountry centres.[72] By April 1931 the reserves in India had been greatly strengthened by gold receipts of 2.5 million pounds. The Indian government estimated that gold flows into the Bombay mint between January

[69] On India Office opposition to Indian government controls, also see IOLR L/F/6/1180, note by Kershaw dated 22 September 1931.

[70] Henry Clay, **Lord Norman**, 1957, p.363.

[71] Macmillan Committee, **Report**, para.162. The gold exporting countries in this period were chiefly Brazil and Argentina and Spain. These three countries and Australia soon imposed checks on private gold outflows.

[72] IOLR L/F/6/1172 F.37, P&O Banking Corporation to Kisch, letter dated 1 January 1931. Some gold had also been shipped to France and Kisch was keen to know the arithmetic of this operation. See Kisch to Mocatta, letter dated 2 January 1931 and the latter's reply dated 3 January 1931 in the same file.

and September 1931 averaged a million pounds each month. These and the early shipments of gold clearly represented distress sales by the Indian peasantry.[73] By September 1931, gold in the Indian portion of the Gold Standard Reserve totalled 27.2 million pounds, while reserves in London totalled 12.8 million pounds.[74]

As the exchange reserves in London dwindled and as the gold reserves in India grew, Whitehall began to demand that the Government of India ship gold to London. As the drain of gold from London became more severe through the summer of 1931, so the demand that New Delhi export gold became more strident.

The earliest India Office request for gold came in the spring of 1931. The Indian government itself seemed to be persuaded of the idea as its gold holdings grew, if only to dull the India Office clamour for more contraction than they felt able to manage. But New Delhi feared that Indian public opinion would view official gold exports as being aimed at supporting an overvalued rupee and the resulting controversy might offset its advantages. So, to the dismay and incomprehension of the India Office, the Government of India expressed the wish to wait till the rupee was stronger before shipping any gold on its account.[75]

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[73] IOLR L/F/7/474 F.22, Colln.43, Viceroy to Secretary of State, telegram dated 24 April 1931; L/F/6/1175 F.2222, Viceroy to Secretary of State, telegram dated 1 April 1931; L/F/6/1188, Viceroy to Secretary of State, telegram dated 20 January 1932 and George Schuster, **Private Work,** 1979, p.115.

[74] Government of India, **Report of the Controller of Currency**, relevant years; also see IOLR L/F/6/1177 F.3693, Minute by Kisch dated 4 August 1931.

[75] IOLR L/F/7/474 F.22, Colln.43, Viceroy to Secretary of State, telegram dated 24 April 1931, part 2. A minute by Kisch said that "at last" the Government of India was prepared to sell gold, though its views regarding timing was the opposite of the "true argument" and "poor reason". However, having at length begun to move, the Indian government should be lead gently in the "right direction". See IOLR L/F/7/474 F.22, Colln.43, Secretary of State to Viceroy, telegram dated 28 April 1931, part 4 and L/F/6/1175 F.2222, "Notes on Viceroy's telegram of 24 April 1931".

The contrast between the policy adopted in 1919/20 when reserves had accumulated in London and that in 1931 when reserves accumulated in India is illuminating. In the former case, as we saw in Chapter **III.1**, the India Office hoped that in defending a revalued rupee, London reserves would be liquidated and the

By early May, the India Office was getting increasingly impatient with New Delhi's continued cold feet in regard to gold exports.[76] In the meanwhile, the Governor of the Bank of England advised postponement of the sale of Indian gold till the autumn and there the matter rested for some time.[77]

April and May were periods of relative ease for the sterling. But by June 1931, the strain of resumed French withdrawals began to be felt and the drain on the Bank's reserves revived. At the end of June, the India Office reopened the question of Indian gold, which, only six weeks previously, had been put away till the autumn.[78] The Government of India resisted exporting gold for the same reasons that it

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consequent contraction would restore reserves in India (as rupees came back from circulation) without the need for metal imports. The counterpart of this policy in 1931 would have been for the authorities to devalue the rupee so that India's trade position improved, capital outflows were reversed and expansion reduced the metallic reserves in India. Like the strengthening of Indian reserves in 1919/20 through metallic imports, this policy too would not have accorded with Britain's interests. Regardless of whether a 1931 devaluation would have been expansionary in the above manner, the contrast between policy in 1919/20 and 1931 suggests strongly that policy options in India were constrained by the metropolitan financial interest. In both cases, policy in India was deflationary.

[76] IOLR L/F/6/1175 F.2222, Minute by Kisch dated 4 May 1931.

[77] IOLR L/F/7/474 F.22 Colln.43, Secretary of State to Viceroy, telegram dated 6 May 1931. It is not clear why Norman wanted the postponement. The reason given in the above telegram was that the Indian government might need to give up gold in the autumn. But autumn drains were a London phenomenon while India usually faced an inflow of funds at this time. At the worst, outflows of capital from India would have slowed down as the busy season approached (unless the weakness of the sterling lay at the root of the rupee's crisis). It may also be recalled that in May, the pressures on the sterling had eased. It seems possible therefore that the Governor wished to keep Indian gold out of the market till the autumnal drains revived in London. Secondly, it is probable that Indian gold exports in May would have been untimely since it might reduce the compulsions for the policy of contraction that he was hoping to force the Labour government to adopt. That Norman was often a law unto himself in these matters is not as far-fetched as it appears at first sight. In July and August 1931, he advised the French and the Americans not to lend to Britain unless she reduced her public expenditure drastically. This, among other things, gave rise to suspicions that a "bankers' ramp" conspired to bring down the Labour government.

[78] IOLR L/F/6/1178 F.4247, Secretary of State to Viceroy, telegram dated 30 June 1931.

previously put forward, but also cited a prospective rupee loan to support its case.[79]

Matters rested for another six weeks before the India Office returned to the subject. Now it insisted that large sales of sterling made gold exports imperative to restore reserves in London, especially as the gold receipts of the Government of India nearly equalled the sales of sterling by the government.[80] The stiff India Office telegram that followed this minute demanded "immediate" shipment of gold of the value of 6.5 million pounds. The Government of India continued to resist the suggestion, since in its view, the reserve position of the government provided "ample margin for any emergency". If there was a sudden increase in sales of reverse council bills, it replied, the Bank of England should extend credit to the India Office against gold in transit.[81]

From early September, the Indian authorities began planning to ship some sovereigns but, in order to stem domestic criticism, proposed their simultaneous sale in India at a better price than they would fetch in London. The sovereigns would have realized Rs.13-4as in London, with the Indian government meeting the freight, insurance charges and the commissions. But the India Office rejected the plea to sell sovereigns at Rs.13-5as to Rs.13-10as in India and insisted that no sales should be undertaken at less than Rs.13-10as-8p., which was the parity price of the gold, plus twice the freight and insurance charges. Any other course, the India Office

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[79] IOLR L/F/7/474 F.22, Colln.43, Viceroy to Secretary of State, telegram dated 13 July 1931.

[80] IOLR L/F/7/474 F.22, Colln.43, minute by G.H.Baxter dated 26 August 1931.

[81] IOLR L/F/7/474 F.22 Colln.43, Secretary of State to Viceroy, telegram dated 28 August 1931 and reply from the Viceroy dated 31 August 1931. In his telegram dated 10 September 1931 the Secretary of State conceded that gold exports were urgently required despite the large size of his sterling reserves because the latter were not liquid enough to enable early realization.

warned, would increase gold consumption in India.[82] Soon after this, the closure of the gold window in London temporarily relieved New Delhi from pressures to export gold on the official account.

Apart from the fear of an Indian default on the London market, there is no direct evidence that Whitehall's aim in seeking official Indian gold exports in this period was to secure Britain's liquidity position. Of course, the latter constrained India's choice of policy. Besides, in the light of the evidence in the earlier chapters, it is not improbable, despite the absence of direct references to this by the policy makers in London, that they continued to use a similar model as in the 1920s and refused to countenance a rupee devaluation (or domestic sovereign sales) also because of their effect on the composition of India's imports. Even after sterling left the gold standard, although a rupee devaluation might have made gold exports more profitable, it is moot whether, with a rise in the prices of her commodity imports and their domestic substitutes and perhaps of domestic incomes, gold dis-

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[82] IOLR L/F/7/474 F.22, Colln.43 telegrams dated 10 September and 17 September respectively. The gold price, including twice freight and insurance charges (i.e., London - Bombay and Bombay - London), was designed to make the authorities sell gold in India at its replacement cost in London, on the notion that the gold was imported from London but the reserves would have to be replenished from India. The purpose of this formula, as we have seen, was to reduce the social demand of gold in India. Its absurdity is now evident from the fact that though ordinarily, the sovereigns could fetch a higher price in India than they would in London, the Government of India was being compelled to export the gold to London at its own cost!

The India Office insistence on gold exports rather than gold sales is curious. Domestic gold sales in India would have been contractionary - as in 1920. However the India Office complained that Indian gold exports would provide another route of escape from the rupee but did not consider that the rupee holders who took that route would not demand reverses. In 1919/20, official sales reduced gold imports and led to gold exports and the India Office welcomed this effect. But in September 1931, private Indian gold exports might not have been as useful for London. The India Office might have feared that rupee-holders who exported gold as a means of withdrawing funds from India, would ship it directly to countries outside the sterling area and the gold would no longer be available to meet drains or create credits in London. Note that Indian gold exports that took place in December 1930 went to Paris and not to London. Thirdly, note that one India Office objection to gold sales - that they would increase the social demand for gold in India (and increase gold imports) - contradicts another - that gold sales would provide rupee-holders new means of getting out of India.

hoarding in India and their exports would have been sustained at pre-devaluation levels. As we suggested earlier, in the light of the policy pursued in 1920, devaluation and expansion - not defending an overvalued rate and contraction - should have been the preferred policy in 1931. But this did not happen, and as in an opposite set of circumstances in 1920, the policy in India was deflationary. Given the implicit role that gold imports already played in the India Office's model and their appreciation of the impact of the Indian gold demand on the availability of the metal to the European countries, it seems unlikely that they were unaware of the likely benefits for London of Indian gold exports (whether official, or unofficial). Thus her need for gold may have obtruded on London's policy-making for India in the depression in more ways than a literal reading of the primary sources may reveal.[83] Further, India Office bureaucrats, were well aware (through their connections in the City and with the Treasury) of the official view of the origins of the depression and the steps that needed to be taken internationally to relieve the British position. For example, the "Kisch plan" which proposed a means of easing the maldistribution of monetary gold - the most important cause of the crisis in the British view - was authored by an official at the India Office.[84] The surprise is not that officials at the India Office were well versed in their comprehension of the British view of the inter-war depression. Rather, the surprise is that there are so few references to it in the records that the omission seems almost self-conscious.

Moreover, Whitehall's open appreciation of the effects on London's financial position of Indian gold exports suggests that Indian gold exports before September 1931

[83] As the Committee of Economic Information of the Economic Advisory Council makes clear in one of its reports, the connection between the gold flows and security flows was well understood as also the implication of the direction of these two flows for the liquidity position of the key-currency country. See PRO T160/77 F.15583, 23rd. Report, October 1937, Part 2, para.55.

[84] See I.M.Drummond, **The Floating Pound**, 1981, p.139 for a brief discussion of the Kisch plan.

would undoubtedly have been useful. Treasury and India Office bureaucrats would also have been aware of the benefits for London of Indian gold exports and these might have been too obvious to mention in the context of communications within Whitehall while being too controversial to mention in communications with New Delhi. Further, Whitehall's continued insistence, even after sales of reverses had ceased and the rupee had stabilized by the winter of 1931, that the Indian government export gold suggests that the former may not have laid bare all its motivations.

For example, by October 1931, sales of council bills had resumed. Despite the continued political confusion, India had begun to attract back funds that she had lost previously.[85] But as late as November 1931, the Treasury was insisting upon official gold exports from India.[86]

The India Office also took up the refrain, with the suggestion that exports would enable India to take advantage of the premium on gold. This was an interesting explanation. If the purpose of official gold exports was to secure the premium, it would have made sense - as the Indian government pointed out - to wait for it to rise. New Delhi also did not fail to remark that the India Office was now shifting its ground. Reserve depletion was no longer a threat. Remittances to India were substantial and lastly the world was moving out of "devisen" and into gold and it would be inopportune for India to do the contrary.[87]

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[85] IOLR L/F/6/1175 F.2222, Secretary of State to Viceroy, telegram dated 23 October 1931 and Controller of Currency to Secretary of State, telegram dated 27 October 1931.

[86] PRO T160/474 F.12471/06/1, Leith-Ross to Hopkins, undated note of November 1931. The note referred to Schuster's attitude to gold exports as "unsatisfactory" and said "we must get him to part with about 5 million pounds at least".

[87] IOLR L/F/7/474 F.22 Colln.43, Secretary of State to Viceroy, telegram dated 12 November 1931 and the latter's reply dated 17 November 1931.

Increasingly now, the India Office began to focus on the revenue losses inherent in the gold holding of the Indian government, rather than on the premium. Baxter of the Finance Department noted, a few months later, that the reasons given above by the Government of India were "out of date to a great extent." There was no large flight from devisen to gold. The telegram based on this note said "world confidence in sterling (had) been re-established" and the present was an appropriate time for the Government of India to sell gold.[88]

It is curious that the India Office should now use the revenue argument to support its demand for an Indian gold sale. Certainly, in March 1932, the earlier justification for official gold sales had disappeared. The rupee was stronger, remittances were high and the Indian current account position was strong. By now an Exchange Equalization account, whose unstated purpose was to keep the pound down, was in active contemplation and the Treasury was soon to set it up. Therefore, the absence of possible capital gains due to premature gold sales (or capital losses on sterling holdings were the sterling to fall) should have been considered by the India Office at least as much as the likely revenue gains. The complete disregard of this aspect by the India Office casts some doubts on their motivations for recommending that the Government of India liquidate their gold reserves and hold them in sterling.[89] It is an interesting coincidence that whenever London encountered a liquidity crisis and the Indian government had some gold to spare, the India Office (as it did in 1907/09, during the First World War and in 1923) began urging the Government of India to consider the revenue gains of gold sales.

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[88] IOLR L/F/7/474 F.22.Colln.43, minute by Martin dated 8 March 1932; minute by Baxter of the same date.

[89] The India Office asserted that there was a smaller risk in holding sterling than in holding gold. See IOLR L/F/6/1201, F.1623, Secretary of State to Viceroy, telegram dated 15 March 1933. This may have been true in 1937 but not in 1933. But in 1937, the Treasury, as we see below was keen that the "minor central banks" held gold rather than sterling.

As we have suggested already, the most significant outcome of the depreciation of the sterling was the steady stream of gold that flowed out of India on the private account. There is no doubt that the difference between the price of gold in London and in India stimulated these exports.

But, even before gold prices increased, i.e., even before sterling left the gold standard, gold estimated at about a million pounds was coming into currency offices all over India each month. These could have only represented distress sales. As the recovery in Indian prices did not begin till 1934/35, there is no reason to believe that distress gold dis-hoarding ceased after September 1931, though quite possibly, the peasant who sold his gold to the trader or the **shroff** got higher prices after that date. However, as Rothermund points out, and as Indian economists pointed out at that time, local money-lenders and **shroffs** were touring the countryside and forcing the rural population to part with gold in payment of their pre-existing debts. Therefore it is likely that the increase in gold prices in India and in London may have increased gold dis-hoarding in India, but, not to the advantage of the Indian house-holder. The latter may have parted with the gold to escape losing his land or perhaps slipping into bondage and the profits of the increase in gold prices, largely retained by intermediaries.[90] The British and Indian

[90] D.Rothermund, **An Economic History,** 1988, pp.104-05; the contemporary Indian economists who attributed gold dis-hoarding to distress included P.Banerjea, **A Study of Indian Economics,** London, 1940, Fifth Edition, p.260 and H.L.Dey, "Monetary System and Policy" in R.K.Mukherjee and H.L.Dey eds., **Economic Problems of Modern India,** London, 1941, Vol.2, pp.217-48.

It is interesting to speculate on the use to which the proceeds of gold exports were put. The use of the sterling proceeds is easily ascertained. They were not used to support domestic expansion. Instead, they reduced India's sterling debt and replenished the gold standard reserve in London which had been run down by reverse sales in the previous year. It is much less clear what happened to the rupee proceeds. Tomlinson cites the growth in Post Office savings deposits, joint-stock banks etc. to suggest that gold exports brought new liquidity to the Indian economy. The monetization of hitherto non-monetary assets would undoubtedly inject liquidity into the system. But the assumption inherent in the argument that the new liquidity reappeared as savings in the portfolios of individuals may be optimistic. For one thing, the increase in post office deposits may have represented governments thought that the desire for profit lay at the root of Indian gold exports. They refused to consider that destitution may have equally been at work.[91]

Indian gold exports caused little surprise in London. Keynes had foreseen the conditions in which India would export gold. One of Montagu Norman's biographers points out that the he was not surprised by the exports and had indeed been expecting them.[92] Whether expected or not, Indian gold exports were seen to serve British interests in this period and Whitehall was keen to ensure that they did not cease.

Thus in January 1932, the Treasury, which earlier in September 1931 had opposed imposing capital controls in India, objected to the Indian government's proposal to

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a lagged response to a rise in the number of post office savings bank outlets. These increased some 20% between 1924/25 and 1930/31 when their deposits did not grow by much. The increase in the number of branches of joint-stock banks outstripped the rate at which deposits grew. Similarly, other explanations for the growth in deposits would seem equally consistent with the facts. As urban real incomes increased in the depression, urban savings may have been invested in this form, especially as high gold prices prevented savings being held in the previously desired way. The failure of the deposits of cooperative banks to rise by much supports the above conjecture. The latter were mainly in agriculture. According to Raymond Goldsmith's figures, Indian agricultural debt increased from Rs.11500 million in 1929 to Rs.18000 million in 1939. The ratio of agricultural debt to annual income doubled and a quarter of the agriculturalist's income went towards debt servicing in 1939 as against 13% in 1929. In the economy as a whole, there was net dissaving. See Tomlinson, **Political Economy**, p.38 and Raymond Goldsmith, **Financial Development**, pp.126-28.

[91] See for example the views of F.Stewart in CCA Grigg Papers 2/20, letter to Grigg dated 19 October 1934. This view enabled the India Office and the Treasury to claim with an easy conscience that they had wrought a "miracle" in the asset habits of the "East".

But even the Treasury was not unanimous on whether the desire for profits or distress lay behind the Indian gold exports. An early Treasury draft of a report of the China Committee, which rejected an increase in silver prices, drew parallels with Indian gold dis-hoarding and said the combination of distress and speculative selling had produced "grave results" in the form of the "great diminution in the gold hoards of India." This sentence was removed from the final draft. See T177/21 Undated draft report of the China Committee, but written in 1934.

[92] Henry Clay, **Lord Norman**, 1957, p.400.

lift these controls. Treasury officials felt that the measure "may diminish the export of gold which is at present the only legal method of exporting capital from India. The export of gold has been very useful for the sterling."[93] But the India Office assured the Treasury that gold exports would not be affected by the proposed move. "We have no reason to think that the flow of gold is drying up." The Bank of England also thought likewise.[94]

The Congress Party's agitation against gold exports in January 1932 aroused concerns in London. The India Office was quite relaxed about the effects of the agitation, but the City's fears found reflection among politicians. In the Parliament, the Secretary of State was asked what action he was taking on the Congress Party's threat to close the bullion markets. The Prime Minister, Ramsay Macdonald also expressed anxiety. He wrote to Samuel Hoare, quoting a "city friend" who had received a "cable from a prominent financial man" that the picketing of the gold exchange was affecting Indian gold exports. "Obviously, at present exchange rates large amounts of gold would be shipped were it not for the picketing .... I do not know if you can do anything about this." Hoare wrote back to the Prime Minister to convey the Indian view that picketing would not affect gold exports. Authorities in Delhi and Bombay were in touch to ensure this, he assured Macdonald.[95]

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93 The Treasury's original opposition is in PRO T160/400 F.12471, Annex 7, Robinson's note dated 21 September 1931. The January discussions are in F.12471/06/2. See especially Waley's minute dated 22 January 1932. The Treasury letter to the India Office on this subject however made no mention of the benefits for the sterling of Indian gold exports. See Leith-Ross to Kershaw, letter dated 22 January 1932.

94 PRO T160/474 F.12471/06/2, Kisch to Leith-Ross, letter dated 25 January 1932. Interestingly, Kisch attached no conditions to Indian gold exports such as the sterling-gold parity. The Governor's views are reflected in Hopkins to Leith- Ross, note dated 26 January 1932.

95 IOLR L/F/6/1188 F.334, Macdonald to Hoare, letter dated 19 January 1932 and Hoare to Prime Minister, letter dated 22 January 1932. As late as 1933, the India Office was keen to ensure that Indian gold exports continued uninterrupted. For this reason they opposed a 2% export duty on gold which the Government of India had proposed and suggested instead an impost on tea exports! See IOLR L/F/6/1199 F.1, note by Kisch dated 4 February 1933 and Secretary of State to

There was no doubt that Indian gold exports were an important phenomenon in the international economy in the depression years.[96] To those in London who were entrusted with the charge of Indian finances, they were especially welcome. The rupee which was weak in August-September 1931 was easily stabilized. Capital outflows ceased and by the end of October 1931, demand for remittances began to make themselves felt. By January 1932, the India Office was confident enough about the Indian resource position to discharge a 15 million pound loan that fell due during the month.

The surge of gold from India and the discharge of the January loan were together a source of great celebration in Whitehall and New Delhi. Viceroy Willingdon was jubilant. In a letter to Baldwin, he said, for the "first time in our history owing to the economic situation, Indians are disgorging gold ... We have sent over to London in the past 2 or 3 months something like 25,000,000 sterling and I hope the process will continue. I believe at the moment we are a larger exporter of gold than S.Africa!"[97]

Viceroy, telegram dated 4 February 1933.

[96] In 1931/32, Indian gold exports (about 45 million pounds) almost equalled South Africa's gold exports during the year. In the next year, at the trough of the depression, India had a trade deficit, but managed a current account surplus on account of her gold exports which peaked at 50 million pounds. This was about 10 million pounds lower than South African exports. As gold prices rose, South African output and exports were stimulated, but even so, Indian exports were a significant in relation to the former till 1935/36. It equalled 70% of South Africa's exports in 1933/34, 64% in 1934/35, and 38% in 1935/36. Although in 1936/37 and 1937/38, the Indian share fell to 25% and 16% respectively, set against the fact that India had been importing between 15% and 30% of the world's gold output until 1930, the Indian outflows of the depression years are remarkable. In these years, South Africa produced between 35% and 50% of the world's total output of gold. Indian figures are from the same source as Table **VI.1** above. South African and world output figures are from Leo Katzen, **Gold**, 1964, pp.18-19, 40-41 and 60-61.

[97] Cambridge University Library, Baldwin 105, Willingdon to Baldwin, letter dated 17 January 1932. The comparison with South Africa perhaps illustrates the international perspective in which Indian gold exports were viewed. IOLR L/F/6/1191 F.2734, "Statistical Note on Indian Finance" undated, but drafted in July 1932 also made the comparison with South Africa.

The mood in London was equally euphoric. In an openly self-congratulatory note, the Secretary of State claimed credit for himself and his advisers for "tacking" the rupee to the sterling and thus causing Indian gold exports. He said the step had been taken in the "teeth of Indian opposition" and showed how important London's control over India was. The Cabinet congratulated the Secretary of State on "what has been accomplished ...."[98]

If the liquidation and exports of formerly hoarded assets was an expansionary influence, it was not reflected in the Indian price level. The trough in the Indian price level was touched in March 1933 at 82 (1914=100). Only in July 1933 after nearly two years of buoyant gold exports, did Indian prices return, albeit briefly, to the September 1931 level. Thereafter, the index stayed below that level till December 1934 despite continued exports of the metal and current account surpluses. Only from 1935 did Indian prices show a tendency to rise although there were several months in 1935 when the index fell below 90.[99] In July 1934, Henry Strakosch expressed concern over the absence of any perceptible impact of the gold exports on domestic recovery and suggested that the sterling be so managed as to promote expansion in India and in other parts of the Empire. The India Office-Treasury response illustrates how far domestic recovery priorities in India were in their minds, and the extent to which they identified Indian recovery with the position of its current account. A Treasury official said he did not "attach much weight to Strakosch's views as to the desperate plight of India; Kisch tells me that the financial position is greatly improved, and there is no doubt that India is

[98] PRO T160/400 F.12471 Annex.7, "The Repayment of an Indian Loan : An Incident in the History of Whitehall Control", C.P.23(32) dated 15 January 1932. The Cabinet resolution was passed on 20 January 1932.

[99] In September 1931, the index stood at 91. The indices referred to above are the Calcutta Index of Wholesale Prices from **Statistical Abstracts of British India**, Parliamentary Papers, Cmd.6079, HMSO, London, 1938, p.385.

getting through the crisis better than almost any other country."[100] Similarly, when Schuster wanted the Treasury to keep the interests of primary producers' in mind whilst managing the sterling, the official Treasury reply was non-committal. But privately the response was that "... the (Indian) tail can't expect to wag the Bulldog".[101] A similar attitude characterized the British approach to Imperial monetary policy at the Ottawa Conference. Sterling policy was made with Britain's interests, rather than the interests of the Empire, in view.[102]

But the Treasury wished to keep the sterling low, among other reasons, to promote Indian gold exports, especially as the latter provided definite advantages in regard to the management of the sterling.

As Clay points out, within weeks of their commencement, Indian gold exports, enabled Britain to repay a large part of the credits raised in Paris and New York, well in advance of their due date.[103] The remaining credit was repaid in January 1932. British financial papers recognized that Indian gold exports had provided the Bank of England with the means to buy dollars when there had been a flight from them in October 1931 and that in general, Indian gold exports were proving of help to the sterling.[104]

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[100] PRO T177/12, Phillips to Hopkins, note dated 20 July 1934.

[101] PRO T160/474 F.12471/06/2, Viceroy to the Secretary of State, telegram dated 9 March 1932; Treasury to India Office, letter dated 23 March 1932; Leith-Ross' remarks are on Waley's minute dated 5 March 1932.

[102] See I.M.Drummond, **The Floating Pound**, 1981, pp.23-27 for an account of the monetary discussions at Ottawa.

[103] Henry Clay, **Lord Norman**, 1957, p.400

[104] IOLR L/F/6/1180 F.6060, The **Investors' Chronicle** and The **Economist**, both dated 30 January 1932. The **Economist** said, "no doubt ... a factor of prime importance ... is ... India's gold shipments. Just as last week it became apparent that India's gold shipment to London had enabled her to cover current debt maturities, so the shipment of the same gold to France has helped to enable us to repay our debts to Paris and New York."

The most important device for managing the sterling after September 1931 was the Exchange Equalization Account. As early as December, the Treasury privately ruled out a large increase in the sterling parity of about $3.40 unless world prices rose.[105] By February 1932, the Treasury was feeling more confident in its view that rather than allowing gold inflows to push up the sterling, the Bank of England should follow a policy of rapid reduction in the bank rate and continued purchase of gold. "If the reduced bank rate, the loosening of credit in this country and the purchase of foreign exchange do not cure the inflow it will be necessary to let the pound respond in some degree. But I should keep any rise slow ....", a Treasury official noted.[106] As the Treasury admitted, the fundamental reason for establishing the Exchange Account was the "desire to keep **down** the pound. We cannot however put it quite as bluntly as that ...."[107] By enabling intervention in the gold and foreign exchange markets, the account allowed Britain to pursue policies aimed at domestic recovery and by insulating the domestic economy from the effects of speculative capital flows, preserve the conditions of cheap money so necessary to domestic recovery.

Indian gold exports played a significant part in enabling the Exchange Equalization Account to operate. Drummond has suggested that, more than India's gold sales, the "eccentric strength of Britain's capital account" allowed her to accumulate gold

105 PRO T175/57, Hopkins, "Note on Mr. Keynes' memorandum of 16 November" dated 16 December 1931.

106 PRO T175/57, memorandum by Phillips dated 5 March 1932.

107 PRO T175/57, "Exchange Equalization Account Proposals", memorandum to the Chancellor of the Exchequer by Hopkins dated 6 April 1932, emphasis in the original. Also see Susan Howson, "The Management of the Sterling, 1932 - 1939", **JEH**, Vol.40, No.1, 1979, pp. 53-60 and **Sterling's Managed Float : The Operations of the Exchange Equalization Account, 1932-39**, Princeton, 1980. Officially, the UK Finance Act of 1932, Part IV said the Account was set up "... for checking undue fluctuations in the exchange value of the sterling."

in the account.[108] But there was no evidence yet, in 1932, of the future strength of the British capital account. She continued to be subject to unpredictable outflows and Indian gold exports enabled her to buy the foreign exchange necessary to steady the sterling and meet London's obligations. As we have seen earlier, Indian gold exports had already enabled Britain to discharge some of her debts late in 1931. But till the capital account improved, British authorities could not always be in a position to buy gold or foreign exchange without weakening the sterling, and here Indian gold exports proved crucial.

For example, in February 1932, the Bank of England did not want sterling to fall while it intervened to buy dollars and francs. According to the Treasury, this was possible because of improved trade figures, debt repayments, good revenue returns, new tariff proposals, and the weaker dollar. At the same time, gold movements had come in support of the sterling and the most important of them was India's exports of gold which represented almost two-thirds of Britain's total receipts of the metal during the month. With " ... any diminution in supply (of gold) from these sources it would be by no means so easy to continue heavy exchange purchases ...." Further, the strength of the sterling was seasonal. In order to maintain it in the autumn months, foreign balances needed to be acquired now. War debts and reparations may also involve gold outflows. "Our store of gold is low ..." and would fall further if the Treasury credit of 80 million pounds was repaid in September 1932. If (we) should fail to purchase sufficient exchange for that purpose it would be necessary to draw further on our gold reserves."[109] Indian gold exports continued throughout the next few months and helped sustain sterling through the autumn drains. A fall in exchange reserves, withdrawal of foreign money owing to low interest rates in London, and an impending War Loan payment led to a greater

108 I.M.Drummond, **The Floating Pound**, 1981, pp.50-51.

109 PRO T175/57, "The Present Position of the Pound", memorandum by Phillips undated but written in February 1932.

weakening of the sterling than the British authorities wished to see. But " ... Indian gold still ... comes in at a substantial rate. We continue to get the advantage of it, and it is a material help at this difficult season of the year."[110] As late as January 1933, Britain was relying on Indian gold exports to repay an instalment of her war debts to the USA.[111] With large gold inflows, the phenomenon of a gold shortage, at least where Britain was concerned, began to disappear.

Even after 1933, when the capital account would have enabled her to buy foreign exchange while keeping the sterling within a target zone, the importance of gold receipts from India for the management of the Exchange Equalization Account did not diminish. By the spring of 1933, because of expectations of currency instability, it had been decided to reduce exchange holdings in the account. As Table **VI.6** shows, the additions to the account thereafter were entirely in the form of gold. Had Indian gold not been available, British exchange rate policy would have been much more vulnerable to American efforts to push up the sterling and the Exchange Equalization Account would have lost its teeth. Therefore, regardless of the strength of her capital account, sterling management continued to depend on the greater availability of gold and to the extent that Indian exports contributed to this state of affairs, it benefitted Britain. To the extent that the steadying influence of the account eased Britain's capital account, India's gold exports helped sustain the health of the latter.

Given the significance for Britain of Indian gold exports in this period, it was not surprising that the need to promote them was a major consideration in determining the level of the sterling. One Treasury official thought that an important argument

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110 PRO T175/70, Hopkins' note to the Chancellor of the Exchequer dated 15 October 1932.

111 PRO T172/2082, memorandum by Hopkins' dated 21 January 1933.

TABLE VI.6 BANK OF ENGLAND AND TREASURY HOLDINGS OF GOLD AND FOREIGN EXCHANGE : HALF-YEARLY, SEPTEMBER 1931 TO 1938

Date	Foreign Exchange	Gold
30/9/1931	12	167
30/3/1932	84	157
30/9/1932	26	226
31/3/1933	48	314
27/9/1933	20	339
27/3/1934	0	422
25/9/1934	-2	414
27/3/1935	-1	430
25/9/1935	-2	497
25/3/1936	0	522
30/9/1936	-1	639
31/3/1937	-10	716
30/9/1937	8	820
31/3/1938	-2	835
30/9/1938	-16	710

All figures in millions of pounds at current prices and exchange rates; 0 indicates holdings less than 500,000 pounds.

Source: Susan Howson, **Sterling's Managed Float**, 1980, p.62.

for keeping the sterling down was that of encouraging Indian gold exports. "The most desired objective is a general rise in world gold prices and ... the most single powerful force to that end at the moment is the flow of gold from India. Now the volume of that flow depends ... on the depreciation of the rupee, that is the depreciation of the sterling. A rise in the sterling would have a deadening effect which would be most unfortunate ...." He added that at $3.60 or $3.70, gold exports from India would not be checked, but at $3.90 they could cease.[112]

Thus, British priorities, rather than those of the countries in her Empire, dominated the formulation of sterling policy. Indian gold exports were recognized as a reflationary influence globally. But in India itself, neither gold exports nor the depreciating sterling lead to an increase in prices. Indian prices fell till 1934/35 before rising slowly again while British prices had begun to recover earlier.

The silver question also offers evidence of Britain's supersession of Indian interests to her own. This was a festering sore in the economic relations between Britain and the USA during the depression years. The fall in the price of silver which began in 1927 severely affected the politically powerful silver producers in the USA who sought to stabilize the price of the metal. The main cause of the fall, in the American view, was the sale of silver by the Government of India after 1927. They suggested that India discontinue sales of silver - a proposal which was unacceptable both to London and New Delhi. The India Office, under advice from the Treasury

[112] PRO T175/57, Part 2, Phillips to Henderson, letter dated 26 February 1932. Philips was preparing a memorandum on why the pound should be kept low. The memorandum pointed out that Indians were now buying silver instead of gold and this was a "thoroughly satisfactory development". This is another example of the centre desiring and approving the switch of asset preferences on the periphery from gold to silver. The memorandum added that, in order to enable Indian gold to flow out, the sterling and the rupee should not be stabilized because "there (would be) no chance of a further profit from an appreciation of the rupee." The memorandum in different drafts is dated 27 and 29 February 1932. Interestingly, in March 1932, the Secretary of State for India was included in the Currency Questions Committee of the Cabinet which oversaw sterling policy. See S.K.Howson, **Domestic Monetary Management**, 1975, p.87.

refused to accept any responsibility for the decline in silver prices and said that the contrary view came from "interested American quarters".[113] The India Office therefore suggested continued sales of silver by India.

The silver question was one in which - at least in 1931 - Indian interests were ranged against British interests. Regardless of who was to blame for the fall in silver, it would have been in the interests of the USA and India to see that silver prices rose. Left to themselves, the two countries would not have been unable to arrive at a silver marketing agreement.

But Britain's chief concern in the financial sphere was related to the distribution of gold, and here also, the USA was a major player. The British aim, till 1933, was to use the American silver predicament to persuade her to discuss measures to alleviate the mal-distribution of gold. For the Treasury itself, it was an almost a costless tactic but it imposed losses on Indian silver holders and the Indian government.

Through 1930, the Americans had been proposing an international conference on silver stabilization. The official British response was unenthusiastic. In public, it proclaimed that the fall in silver prices was part of the general fall in commodity prices the world over, and that the latter needed to be solved before prices could rise. Since commodity prices had fallen, in the official British view, as a result of the liquidity crisis caused by the mal-distribution of gold, the latter had to be on top of the agenda of any international conference.[114] The Treasury was willing

[113] IOLR L/F/6/1172 F.371, Kershaw to Schuster, letter dated 28 January 1931. This might not have been in the strict sense. In an unfinished memorandum for which he had secured some figures from the India Office, Joseph Kitchin blamed Indian sales and demonetization for the decline in silver prices by more than the decline in the prices of commodities. See L/F/6/1172 F.169, Kitchin's memorandum "Silver etc." dated 24 February 1931.

[114] IOLR L/F/6/1181, Treasury brief for a House of Lords question dated 30 September 1931.

to summon a conference on gold distribution, but the willingness foundered on American opposition.[115] In other words, until the Americans took steps to help Britain in tackling the gold problem, she was willing to use the USA's silver problem to her own advantage.

To this end, she was keen to prevent the US proposal for a silver conference from making any headway. The Treasury draft of an India Office telegram to New Delhi said that participating in a conference devoted only to silver would be a tactical error. Silver, the draft said, should be used to force the USA to discuss other issues that underlay the depression. In communicating the draft, the Treasury warned India Office that it might suggest "too close a consolidation of interests" between the British and Indian governments and that the India Office should make "necessary adjustments" before it was sent to India. In the event, the Treasury draft was sent unchanged.[116] The India Office and the City also opposed official Government of India proposals (and unofficial ones from American bankers) for a silver stabilization loan from the USA.[117]

The Treasury was acutely sensitive to Britain's vulnerability on silver, since it would have been quite easy for the interested parties to arrive at an agreement,

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115 PRO T160/547 F.3420/2, Peel's reply to Hunsdon in the House of Lords on 30 September 1931.

116 IOLR L/F/6/1173 F.392, Secretary of State to Viceroy, private telegram dated 19 February 1931 and Leith-Ross to Kisch, letter dated 17 February 1931. The Government of India's mute acceptance of the Whitehall line on silver, although it was not entirely in Indian interests must have been of some surprise to the Treasury itself. Possibly, unlike the self-governing white dominions, the British Indian government still saw the world through London's eyes. At one time, New Delhi proposed floating a silver stabilization loan in New York, but the India Office did not have much trouble in squashing the idea. In fact, in many ways, the silver question (as also gold export question) exposes the London centred view of even the more independent British officials in India, such as Schuster.

117 IOLR L/F/6/1172 F.371, Kershaw to Schuster, letter dated 28 January 1931 and South Asia Archives, Cambridge, Benthall Papers, VII, diary entry dated 7 June 1931.

and she herself would have no direct influence on the outcome. Therefore, it took great care to prevent even unofficial endorsement of the American silver conference proposal in Britain. It was particularly nervous that Manchester, which had been affected by the slump in the Chinese market, might support the American ideas on silver.[118]

Continually, the actions of the British Treasury seemed to emphasize that Indian and British interests on silver were opposed (as indeed they were), while the India Office continued to maintain the pretence that the there was no such conflict. For example, when Germany wanted to buy between 16 and 40 million ounces of silver for subsidiary coinage, the Treasury tried to persuade the Germans to increase their note circulation rather than the circulation of silver coins.[119] Further, when China began to face a currency crisis because her silver coins were being melted down and smuggled abroad to take advantage of the higher prices for silver outside China that resulted from the American silver stabilization programme of 1934, there was a proposal to export Indian silver to China to ease the crisis. But Britain hoped the Chinese problem would become acute enough to compel her to leave silver. With world silver supplies increasing as the metal became demonetized in China, the American stabilization scheme would have become inordinately expensive. The growth of political opposition to the scheme within the USA, it was hoped, would lead to its abandonment. Silver prices would have crashed and out of this turmoil, Britain hoped to retrieve the gain of forcing the Americans to the negotiating table to discuss gold distribution and perhaps, persuading China to peg to sterling. To realise this scenario, the British government refused to allow Indian silver to be

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[118] PRO T160/547 F.3420/2 Leith-Ross to Addis, letter dated 31 March 1931, Anderson to Leith-Ross, letter dated 8 April 1931 and the latter's note dated 15 June 1931.

[119] PRO T160/547, F.3420/2, Leith-Ross to Deputy Governor, Bank of England, letter dated 31 July 1931 and Siepman to Leith-Ross, letter dated 10 August 1931.

exported to China.[120] Even while betraying indifference to the price of silver and Indian interests in the metal, the Treasury was not above trying to make a profit out of India's surplus stocks of silver. It persuaded the Americans to accept silver in settlement of a war debt instalment. Britain bought silver from India at about 21d. per ounce but valued the silver at 27d. while settling the US debt.[121] The London view that the interests of the Empire were synonymous with those of Britain while no interest of any individual member of the Empire was vital enough to require a subordination to it of British interests is exemplified by India's experience with silver. During the First World War India was forced to take silver largely because of Britain's liquidity crisis which it painted as an Imperial crisis. But barely fifteen years on, when India was saddled with large surplus stocks of the now depreciated metal, the British response was one of self-interested indifference.

Finally, in the World Monetary and Economic Conference of 1933, Britain tried to tempt the Americans to stabilize the dollar (which meanwhile had left the gold standard), by making concessions to them on silver. The British Treasury withdrew its objections to a silver agreement which, when it was reached, limited India's annual sale of silver to a maximum of 35 million ounces per year between 1934 and 1938.[122]

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[120] PRO T177/21, Draft Report of China Committee, Part 2 of file, undated but written in 1934. Also see J.M.Blum, **From the Morgenthau Diaries : Vol.1, Years of Crisis, 1928-1938**, Boston, 1959, pp.204-228.

[121] PRO T177/17, Assorted Papers on the Silver Deal.

[122] PRO T160/950F.13798/1, US President's statement dated 21 December 1933. Britain sought negotiations with the USA in 1933 to prevent "more radical exchange manipulation on the part of America including that of setting up an immense Exchange Equalization Fund". See PRO T175/74, Unsigned, undated note, probably by Phillips written in 1933. Britain also wished to ensure, through agreement with the USA, that the gold bloc countries could be kept on gold. See PRO T175/17, Hopkins' note dated 31 March 1933 on Phillips' memorandum, "Exchange Equalization Account" dated 27 March 1933 and PRO T172/2081 and "United States Monetary Policy" memorandum by Phillips, undated but written in October 1933. For an American assessment of the British keenness to ensure dollar stabilization see H.Feis, **1933 : Characters in Crisis**, 1966, p.214 and R.Moley, **After Seven Years**, New York, 1935. Feis mentions that Neville Chamberlain who was the Chancellor of the

V.4 FULL CIRCLE : THE PROBLEM OF SUPER ABUNDANT GOLD

From time to time after the sterling began to float, the question of its return to gold was considered by Treasury officials. After the early shock of a floating sterling had passed, Treasury officials began to enjoy the opportunity that the Exchange Equalization Account gave them, of pursuing domestic stability without paying much heed to the external account. Whenever the question was discussed, the Treasury conclusion was that before Britain could consider a return to the gold standard, the global distribution of gold should have improved in her favour so that she had a "gold basis larger than that required by any other country". Justifying the need to expand the Exchange Equalization Account to realize this need, Hopkins remarked frankly that "... however inconvenient the position may be when we are engaged in advocating economy in the use of gold, we have to face the fact that we could not risk going back to an immediate gold standard without a larger share of the gold supply of the world ...."[123] One year later the same message was repeated. Britain could not return to gold when every gust from abroad created uncertainty for the sterling.[124]

But our story comes to an end with a delicious - if unrealized - bit of irony which reinforces the main argument. As Table **VI.6** above showed, Britain's gold holdings almost doubled between the middle of 1933 and the middle of 1937. The proportion of British gold and foreign exchange reserves to her imports and liabilities also rose dramatically (Table **VI.7**).

Exchequer paid an unexpected visit to Moley (who was an influential aide of Roosevelt and much below Chamberlain in protocol terms) to plead for dollar stabilization.

[123] PRO T175/17, Part 2, note by Hopkins dated 30 March 1933 on Phillips' memorandum, "Exchange Equalization Account" dated 27 March 1933.

[124] PRO T172/1775, Brief prepared by Phillips and Ferguson for the Chancellor of the Exchequer dated 7 March 1934.

TABLE VI.7 BRITISH GOLD AND FOREIGN EXCHANGE RESERVES AS A PERCENTAGE OF HER IMPORTS AND NET EXTERNAL LIABILITIES

Year	R/L	R/M
1931	51%	18%
1932	53	27
1933	69	39
1934	71	60
1935	82	68
1936	98	90
1937	102	87
1938	105	73

L: Net External Liabilities; M: Imports

Source: Susan Howson, **Sterling's Managed Float**, 1980, pp.53-54.

A large part of this increase in British reserves came from the dis-hoarding of previously non-monetary gold especially in the private hoards of the East.[125] Meanwhile as commodity prices failed to rise, the commodity value of gold was even higher as was its value in relation to the total size of international trade. According to figures cited by the Economic Advisory Council of the British Treasury, the gold value of world trade in 1936 was only 40% of what it had been in 1929 while monetary gold reserves as proportion of gold reserves had increased from 33% in the former year to 125% in the latter.[126]

British financial opinion was now exercised by the unusual situation of a gold glut and began to think of ways of eliminating it. The Economic Advisory Council pointed out that though adequate quantities of gold were available, they were not financing international trade but were accumulating in New York and London "where its presence was an embarrassment."[127] It mourned the fact that the minor central banks were no longer holding gold in their reserves.[128] But with the present high price of gold, the purchase of gold was proving to be great burden to Britain and the USA. The balance of payments of the sterling area depended on gold exports, but if USA decided to reduce the burden of its gold purchases either through raising the price of commodities or by revaluing the dollar, Britain would have no

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[125] PRO T177/39, Phillips to Per Jacobson, letter dated 28 August 1937 quoted an estimate by the Federal Reserve Bank of New York, according to which £1000 million had moved from private gold hoards into central bank reserves. Per Jacobson to Hopkins, letter dated 3 September 1937 said the hoarding of gold in the West during 1931-1936 was "almost exactly offset by shipments of gold de-hoarded in the East during the same period." Per Jacobson's own estimate was £400 million.

[126] PROT160/77F.15583,EconomicAdvisoryCouncil,CommitteeonEconomic Information, 23rd Report, **Survey of the Economic Situation**, October 1937, part 2, "International Trade, the Price Level and the Gold Problem", para.52, table 24. All para references subsequently are to this report.

[127] Para.45(iv).

[128] Para.54-55.

choice but to follow suit.[129] Both courses of action had important implications for Britain. An inflationary boom might lead to a boom again on Wall Street (thereby attracting foreign capital) which, apart from being unnecessary, would undermine world confidence in gold.[130] The high annual output of gold meant that a return to fixed parities in the near future would be impracticable because of the high cost of gold stabilization. The burden "might eventually become intolerable, if the annual output of gold remains at its present level, still more if it increased further. Alternatively, if we were to assume a rise in the level of prices and in money costs of production, ... (the inflation which might result) ... might be so large as to cause a most serious disturbance of economic equilibrium."

With the Economic Advisory Council unable to come to any conclusion on how the gold glut was to be tackled, Treasury officials also began to worry about the problem. They realized that if gold availability continued to increase at the same rate, the role of gold as a monetary metal would be threatened. They also saw that the continued relevance of gold as a monetary metal was of great benefit to the balance of payments of the sterling area and to the position of the sterling. A "gold buyers' strike ... (was) a real imminent danger". If increased gold supplies should not increase commodity prices intolerably, "other means of absorbing gold must be found or developed" or physical supply checked or the gold price lowered. In principle, the central banks could absorb gold, but those that could afford to, already had all the gold they wanted. The "industrial arts and Eastern hoarders" could also absorb gold but in recent years, the high price was inhibiting demand and hastening their release of the metal. After considering market possibilities for easing the flood of gold, Phillips said, none of these provided "sensible **immediate** relief". "But if the price of gold were reduced, their effects might be considerable."

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[129] Para.73.

[130] Para.76.

Once confidence in the price was established, it could "stimulate consumption for industrial purposes and do something to check or reverse the flow of gold from the East."[131] Thus the wheel had come full circle. As the world move from a gold shortage to a glut, Indian demand became alluring, than alarming.

A reduction in the price of gold to encourage its absorption by "minor central banks", and "industrial arts and eastern hoarders" would not have been easily achieved. Not the least of the problems was South African objection to the move which came to the fore at the 1937 Imperial conference. It would not have been easy to reverse previously advance technical arguments and encourage the smaller central banks and colonial monetary authorities to hold gold in their reserves. The sterling - dollar parity was also a point of interest for the members of the sterling area though it is doubtful whether Britain would have chosen to make a move on the sterling price of gold except in parallel to an American one on the dollar price for the metal.

Although the growth of London's gold stocks slowed down from the summer of 1937, discussions and speculations on the gold glut continued in Whitehall and across the Atlantic through the summer of 1938. The issue was taken out of the hands of vexed policy-makers and resolved by the evolving political situation in Europe. As war became more imminent, the drain of balances from London resumed and the sterling weakened. By August 1939, the pressure on the sterling was leading to large exchange losses. On August 24 1939, the Bank of England ceased to support the sterling which fell thereafter to $4.03. It was pegged at this level when war broke out.[132]

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131 PRO T175/94 Part 1, "The Present and Future of Gold" by Phillips, dated July 1937. Emphasis in the original.

132 For a discussion of the gold glut situation see I.M.Drummond, **The Floating Pound**, 1981, pp.224-48 and S.K.Howson, **Domestic Monetary**, 1975, pp.136.

VI.5 CONCLUSION

The depression years contained all the tendencies that surfaced in Britain's financial relationship with India, in particular, in the period after the First World War. Britain's liquidity crisis affected the freedom of Indian monetary policy, and whatever world expansion that there was in the late 1920s bypassed India. In the 1930s, the absence of this freedom of policy when it was most needed, deepened the impact of the depression on India. Policy was oriented towards fulfilling current obligations and dictated in the early years by the withdrawal of short-term balances. The latter was the second channel through which the depression came to India (collapse of India's exports was the first), and the passive response to it of the monetary policy authorities rendered official policy pro-cyclical rather than anti-cyclical.

Both in respect of policies towards short-term flows and in regard to longer-term policies of growth in the depression, the Indian experience compares unfavourably, not only with the Japanese experience but also, with the experience of the major Latin American economies who managed to achieve a measure of policy autonomy in this period.[133] This was especially unfortunate in the Indian case because of the large volumes of Indian gold which were exported and which, any reasonably autonomous policy-maker would have used to sustain domestic expansion. As it happened in practice however, the obsession of colonial monetary authorities with the external account (which in turn reflected metropolitan current account problems) dominated the flow of gold and the use to which the sterling receipts were put.

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[133] For a discussion of the Latin American case, see also Carlos F.Diaz Alejandro, "Latin America in the Depression, 1929-39" in Mark Gersovitz et al eds., **The Theory and Experience of Economic Development : Essays in Honour of** Sir **William Arthur Lewis**, London, 1982, pp.334-355.

Thus suggestions that the Indian government buy the gold at current prices and use them to either settle sterling obligations or finance domestic expansion or even accumulate reserves for a central bank were dismissed out of hand. The proposals were rejected ostensibly because prices were unstable and the Indian government might make a loss on its gold holdings. But that was the precise risk that Britain and later the USA were taking and this fact, more than any other would have made Indian government procurement a reasonably safe bet. Given the British interest in Indian gold absorption and release during this period - for reasons that we have explored earlier - and the India Office's interest in securing the British one, there was little that policy-makers in India could have done to make gold disabsorption the cornerstone of reflationary policy.

CHAPTER 7

Conclusion

This study has attempted to examine the impact of Britain's inter-war liquidity crisis on the formulation of monetary policy in India. We have tried to show that, at the very least, Britain's external financial problems constrained policy options in India. More directly, the crisis at the centre subjected the Indian economy to monetary deflation throughout the inter-war years. Since the Indian currency system was constantly undergoing changes in this period, it is impossible to separate the rationale underlying exchange rate policy from those that underlay currency policy in India. Also, the choice of the currency system sheds light on the extent to which Britain's liquidity crisis influenced policy-making in India.

It is a moot question, how far or how soon Britain's liquidity position would have deteriorated, had the First World War not taken place. But her external financial crisis in the war was a major factor in Britain's weakened current account position until at least 1922. Even though the latter improved thereafter, the unstable conditions of the international financial markets made London especially susceptible to short-term capital outflows. Britain's traditional instruments of financing had become feeble and she was now much more dependent on monetary impulses from a mostly introverted American Federal Reserve System. Both to strengthen her current account and to meet the demand for speculative capital outflows, Britain needed to control more closely the movements of gold for almost twenty years after 1917.

India was traditionally a large absorber of gold. After the demonetization of gold in India by the East India Company in 1835, India's gold imports were largely non-monetary in character. British authorities had ensured that India would not demand gold for monetary purposes. The gold exchange standard and the token silver rupee saw to that. Indian non-monetary gold imports had become, by 1913, a source of some concern, but policy-makers seem to have believed that in the long-run, as the Indian banking system developed, the problem would disappear.

However, Keynes had argued that Indian gold absorption was a function of incomes and relative prices. In his view, Indian gold absorption and dis-absorption were anti-cyclical. But Britain was seeking global expansion initiated by American monetary policy, as the preferred means of removing the disequilibria in the international economy in the first half of the 1920s. As global expansion took hold, Indian gold exports would have increased and reduced the impact (at least for Britain) of the given stimuli. Therefore, in a series of short-term expedients, Britain tried to ensure that the promised or real post-war global expansion would not be neutralized by India's traditional role in the international system. In a world of fixed exchange rates, external influences impinge on the domestic economy through the balance of payments. But the rupee floated upwards in an effort to ensure that expansionary stimuli did not increase the demand for gold by India, either because of the income effect or because of the asset-substitution effect that was presumed by the India Office to work in India. Thus, Britain's post-war financial position compelled her to tackle the Indian gold question in the short-term, and thwart India's ability to check inflationary pressures in the world economy.

During the war, India's gold imports were restricted to enable Britain to finance her trade with the USA and support domestic monetary expansion. The domestic convertibility crisis in India that arose as a result of the persistence of silver coinage and the non-availability of gold in the war came handy to the Americans who wished India to make greater use of silver in her currency system. Although this might not have been Britain's preferred solution, she saw that the only alternative to sending silver was the inconvertibility of the Indian note issue. The latter was especially feared because of the increase in the demand for metallic money that it would stimulate. Thus, Britain's liquidity crisis forced India to accept second-class liquidity in settlement of its surpluses over 1915-1919, while the Americans used the increased pressure on silver stocks to push up the price of the metal and deny coinage profits to either Britain or India. As the price of silver rose, the rupee also had to be revalued.

When post-war stabilization in India was being discussed, the need to avert an Indian gold demand was paramount. The rupee was set at 2s. gold so that India's demand for metallic money might continue to be met by silver, whose prices had continued to rise after the war. Although inflation was cited as a justification for the move, we have seen that it was an afterthought for a course of action that would have been adopted any way. In a short-hand form, the fear of inflation also represented the fact that India's preferred import basket did not correspond to what Britain would prefer to see India import. In other words, in 1920, deflation was engineered to check India's imports of gold. An outcome of this strategy was that Indian reserves were liquidated in a manner that suited London's interests best.

After 1920, the aim of the authorities in London remained that of securing a revaluation of the rupee so that expansionary influences in the world economy would spend themselves before renewed stabilization was attempted. However, protests from Indian opinion restricted London's room for manoeuvre so that the final parity was not as high as the India Office would have preferred. Through a process of monetary contraction, the rupee was raised some 12.5% above its pre-war parity (India was the only country in the world to revalue its pre-war currency) and stabilized at that level by a 1926 commission.

Once the depression reached India, this rate proved to be seriously overvalued. But authorities in London refused to countenance an Indian devaluation, nor in fact adopt any policy that would seem to threaten London's financial interests. Thus the policy on short-term capital outflows and Indian gold exports were framed more to take British interests into account than the Indian. Indian gold exports during the depression assisted the management of the sterling and proved, in general, to be an expansionary influence on the world economy. Lastly, as the gold shortage of the depression years became a potentially inflationary gold glut by 1937 (but not until then), British policy makers began to contemplate policies that would stem or reverse the flow of gold from India.

II

We have concentrated on policies and the motivations behind them. There are several reasons for this emphasis. No student is completely immune to the legacy of existing literature. Much recent work has stressed the aims behind British financial policy in India. Our disagreements with earlier studies are quite fundamental. We have tried to show that Indian financial policy has to be situated in the multilateral environment that constrained it or often, influenced it more actively, before the motivations could be judged with any degree of understanding. Our dependence on primary sources also derives from the above belief. It seemed to us that available records had not been studied with sufficient care by earlier scholars and that they had not used records that shed new light on the subject. A student who reads the records superficially (or ahistorically) risks echoing the policy-maker rather than examining his compulsions. It might not be entirely fanciful to suppose that through a synchronic and diachronic study of the sources (examining the text for internal inconsistencies and inconsistencies with earlier texts and explaining them in terms of a common and unique source of contradiction or divergence) we have been able to penetrate the minds of the policy-makers more deeply.

In examining the motivations for policies, we do not wish to judge whether they were honourable. An understanding of the motivations of the policy-makers is intrinsically crucial to help resolve some unsettled questions regarding the economic relations between Britain and her colonies. The exact role that officials in Britain saw for the major colonies has been speculated upon. For example, the denial of monetary autonomy to India, almost until 1947, owes to something more than paternalistic concern. The analysis carried out in this thesis might go some way towards clarifying this question. Lastly, perhaps, the motivations of policy and the circumstances within which it was made are useful inputs into efforts to realistically model the impact of policy.

III

What was the impact of inter-war monetary and exchange rate policy on the course of Indian economic development? There are really two questions here. The minor one is that the external constraint would have played a significant role in ruling out fiscal policies that were elsewhere used to some effect in the depression, and indeed even in the 1920s. Perhaps, a more independent policy might have enabled India to take greater advantage of the stimulus provided by the First World War and promote growth and diversification of the economy through the 1920s. Even in the 1930s, released from the crippling burden of inherited orthodoxy sustained by its uses for the crisis-ridden centre, policy in India and its results might have been closer to the more successful experience of the Latin American countries and Japan.

The second question is more interesting. The impact of short-term monetary policy on growth has been a controversial one. But it might be useful to apply to the Indian inter-war case, the insights that emerged from attempts to explain Britain's slow growth in the 1960s in terms of the impact of stop-go monetary policies on the investment climate. As monetary policy in Britain was oriented towards tackling the precarious balance of payments position, it has been argued, the resulting uncertainty reduced investment. As productivity growth was a function of investment, the uncertainty slowed down productivity growth as well. The latter in turn sustained the weakness of the external account, while countries that invested a larger share of their incomes in industry could overcome the Keynesian payments trap by maintaining high rates of saving and stepping up their rates of productivity growth. Thus a virtuous cycle of investment, growth, current surpluses and more investment was taking place in countries such as Japan and West Germany, while Britain was beset with the problem of low investment, low productivity growth, and crippling payments problems.[1] In general, external constraints and policies need to be more closely studied in relation to their effects on growth in India.

Lastly, the Leninist view of capital flows under imperialism ignores the balance of payments. It is easy to show that the Empire received a relatively small share of British capital exports. This has been used to repudiate, what has now become, the traditional Marxian analysis of imperialism. The latter could perhaps be usefully reappraised from the standpoint of the contribution of the Empire to sustaining the capital exports of the colonial power. The contributions

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[1] W.Beckerman, "Projecting Europe's Growth", **EJ**, Vol.72, No.4, 1962, pp.912-25; Beckerman, W. and Associates, **The British National Economy in 1975**, Cambridge, 1965, pp.44-69; Kaldor, N., "Conflict of National Economic Objectives", **EJ**, Vol.81, No.1, 1971, pp.1-16, "Problems and Prospects of Monetary Reform", **The Banker**, Vol.123, No.571, 1973, pp.986-92 and "Economic Growth and the Verdoorn Law", **EJ**, Vol.85, No.4, 1975, pp.891-96; Lamfalussy, A., **The United States and the Six : An Essay on the Economic Growth of Western Europe**, Illinois, 1963, pp.110-20.

of the colonies (at least the major ones) might have been more significant than their shares in Britain's capital exports may reveal.

It is also tempting to cast the speculative net even wider. What would have been the course of evolution of the international monetary system, had India continued to be on silver or had government policy in India been more non-interventionist? Would the gold exchange standard have come into existence earlier or would the world have moved more smoothly towards multilaterally created liquidity? Would power relations in the system have been different from what actually emerged in the last century, especially as India was seen to have such tremendous influence on the world's liquidity markets? At a time such as the present when the international system is perhaps experiencing a prolonged period of transition, efforts to address questions such as the above may shed some light on how countries gain or lose in the international financial sweepstakes.

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