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REAPPRAISAL: FINANCE AND POLITICS IN LATE COLONIAL INDIA 1917-1947

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TODAY, ALMOST A CENTURY AFTER HOBSON'S FIRST WRITINGS ON Britain's late-nineteenth century expansion overseas, few serious scholars would argue that economics had nothing to do with the phenomenon. Equally, few would suggest that the British empire was only about economics. This plural consensus was, of course, a product of sheer fatigue. Both to participants and others, the debate over the origins of the modern British empire must have appeared never ending at one time: consider here the Davis and Huttenback project which must have been conceived in the early 1970s and came to fruition in the mid-1980s.[1] The debate was also sustained, to some extent, by protagonists and opponents alike caricaturing in each round arguments advanced in earlier ones. Warnings were sounded, notably by Eric Stokes, but with consumers turning producers, the reproduction of a caricatured discourse became almost unstoppable.[2] Thus, by the late 1980s, the rather unwieldy analytical apparatus put in place by Hobson, Hilferding, Lenin, and Luxembourg, among others, had been trivialised by generations of teachers and students and finally by Davis and Huttenback into the 'Hobson-Lenin model' with not enough resemblance to carry weight in a paternity suit.[3]

As with most other plural consensuses, the one on economics and empire went little beyond reiterating the obvious. On the other hand, no other

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1 L. Davis and R.E. Huttenback, *Mammon and the Pursuit of Empire: The Political Economy of Imperialism 1860-1912* (Cambridge, 1986).

2 For critical appraisals of modern readings of 'Leninist' models, see E. Stokes, 'Late Nineteenth-century Colonial Expansion and the Attack on the Theory of Economic Imperialism: A Case of Mistaken Identity?', *Historical Journal*, Vol. 12 (1969); N. Etherington, *Theories of Imperialism: War, Conquest and Capital* (Beckenham, 1984).

3 Thus, while Davis and Huttenback claim to be testing the 'Hobson-Lenin model', neither author of the supposed model is seriously cited in the volume.

resolution of the apparently unending debate seemed possible. This consensus was also, in some respects, a useful one. A number of local-level studies uncovered metropolitan economic motivations which were rarely addressed in global debates, since the latter tended to focus on a fairly limited set of general factors. No longer are we restricted, when talking about economic imperialism, to a discussion of trade and capital flows. No longer, therefore, are we obliged in all cases to look at metropolitan interests or motivations in the monolithic moulds in which earlier discussions of economic imperialism tended to cast them. The empire involved costs, as well as benefits, to the metropolitan power, and would have been unsustainable unless there was a plurality of domestic support for the project. Given, further, that the empire often comprised many countries which could, between them, address a range of interests within the metropolitan economy, it is possible to visualise a variety of factors helping to widen domestic political and social support for the imperial project. Once the mould is broken, moreover, it becomes easier to see that one part of the empire might address different interests over time. For example, India was a captive market for Lancashire cottons before the First World War but ceased to be so during the 1920s. But at the same time her importance to the financial sector of the British economy increased. Britain's cotton producers recognised this shift even as it was taking place, but there was little they could do by way of effective protest. Once this position is accepted, it is a short step from here to argue that one can, in principle, separate the discussion of the economic origins of colonialism from that of decolonisation. Secondly, if each colonisation project was distinct, so might each decolonisation project be. Indeed, the recognition that each decolonisation exercise (while no doubt sharing some common features) was distinct from the others may also enable us to advance beyond the truism which passes for the current frontier of knowledge about the British decolonisation process; that is, that Britain withdrew from her colonies because she no longer had the means to rule them.

II

Against this background this essay aims to appraise the management of the Indian economy during the last half century of British rule and relate the crucial features of the policy regime during this period to the existing literature on Indian decolonisation. The starting point of the argument contained in this essay is the asymmetric approaches historians adopt towards India's significance to the world economy and to Britain's external accounts during the pre-1914 and the inter-war periods. It is perhaps a sign of the extent to which trade dominates finance in the imagination of historians that their assessment of India's contribution to the British economy appears implicitly to be determined by the size of the colony's market for Lancashire products. Before the First World War this market was a large one. But while the role of Lancashire exports to India got the attention it deserved, historians also went beyond trade to focus on India's role as a major protagonist of the late-nineteenth century multilateral trading system and her contribution towards enabling Britain to

settle trade imbalances and sustain capital exports to the rest of the world. Accounts of the currency transitions of the last century also assign a central role to Indian monetary and currency controversies.[4]

Studies of the inter-war period invariably note the steep fall in Indian imports of Lancashire cottons. But this development appears also to have convinced historians to assume that other aspects of the economic relationship between India and Britain had also begun to wither away by this time, and few studies have attempted to follow up the other strands of India's international economic links during the pre-war years to see how they developed or unravelled in the inter-war period. Partly as a consequence, studies of the international economy during the inter-war period tend to ignore India, while studies of India during the same period tend to be insular.[5] Each tendency reinforces the other, so that there is considerable ignorance regarding the role that the colony played in the global monetary and currency controversies of the 1920s and 1930s, and the manner in which it influenced or was affected by wider monetary and currency developments of the period. This is unfortunate for two reasons. First, because in ignoring these issues we miss important changes in the political-economy of the British-Indian Empire, and second because, we are liable, thereafter, to take a rather crude view of the economic priorities of the colonial regime during its final decades. Our knowledge of the decolonisation process also suffers in consequence.

This essay carries forward the argument I have made elsewhere that inter-war India remained of vital importance to the City of London and to Britain's beleaguered financial interests between the wars at a time when the metropolitan economy faced a daunting combination of domestic and external economic imbalances. It goes on to argue that the management of the Indian economy, so as to insulate it from some international influences and intensify the effects of some others, was a key priority of British-Indian policymakers in the inter-war period; one moreover that lent a special edge to political relations between the governments in Delhi and London and those between the former and its allies, many among whom turned critics within the time span covered here. The analysis advanced in this essay also re-focuses attention upon relational (rather than merely structural) hierarchies in the international economic system under colonialism and on the role that colonial economic management played in realising or reinforcing these hierarchies.

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4 P.L. Cottrell, 'Silver, Gold and the International Monetary Order, 1851-1896', in S.N. Broadberry and N.F.R. Crafts (eds), *Britain in the Internatational Economy. 1870-1939* (Cambridge, 1992); E.H.H. Green, 'Rentiers versus Producers? The Political Economy of the Bimetallic Controversy c. 1880-1898', *English Historical Review*, Vol. 103 (1988).

5 A recent example of the former tendency is B.J. Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression* (New York, 1992); good examples of the latter tendency are J. Gallagher, and A. Seal, 'Britain and India between the Wars', *Modern Asian Studies*, Vol. 15, no. 4 (1981), and B.R. Tomlinson, *The Political Economy of the Raj, 1914-1947: The Economics of Decolonization in India* (London, 1979).

Finally, it attempts an answer to the question which has been raised often enough before, but which has not to date been answered satisfactorily. Why did Britain prove so much less willing to part with her control over Indian monetary policies than she was to hand over the reins of the colony's fiscal policies? The devolution of powers to frame tariff policies is commonly attributed to the growing strength of Bombay's cotton mill owners.[6] On the other hand, the latter were frequently outraged by the colonial government's inter-war monetary policies, and protested vehemently against them. Bombay did not have high expectations from the Indian monetary authorities, and a less deflationary monetary regime approximating to a gold standard and more sensitive monetary policies would have sufficed to satisfy a majority of its entrepreneurs. In the event, government policies in this sphere left a trail of bitterness which senior officials believed was a major obstacle to building closer links with nationalist businessmen.[7] If the 'balance of power' swung unambiguously towards India and Bombay during the inter-war period, why was the shift not reflected in the framing of Indian monetary policies? Few political-economic studies dealing with the 'vexed matter of the empire' address this question with the seriousness it deserves.[8] In exploring the rationale of economic management in inter-war India and the evolution of British control over India's monetary policy apparatus during the inter-war years, therefore, this essay also hopes to shed some light upon the links between finance and politics in the closing decades of the British-Indian empire.

III

One reason why, despite its obvious importance, the subject of this essay has not previously attracted the attention it deserves is its obvious difficulty. The importance to Britain of managing the Indian economy towards particular ends was clear to contemporaries, and few economic historians working on these kinds of issues would have missed this fact. India would not have been central to the pre-occupations of many of them, but those to whom she was may have found the whole issue impenetrable, cloaked as it often was in the neutral discourse of liberal economic policy. The rather technical nature of this discourse, with its stress on 'scientific' principles and metaphors drawn from fluid mechanics, shrouded monetary and currency policies in a mystique which few historians have wanted to tackle. Secondly, economic management

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6 C.J. 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), *Imperial Impact: Studies in the Economic History of Africa and India* (London, 1978) for the most convincing argument; and B. Chatterji, *Trade, Tariffs, and Empire: Lancashire and British Policy in India, 1919-1939* (Delhi, 1992), ch. 5 for a 'subaltern' version of the same argument.

7 Schuster to Goodenough, 30 Nov. 1929; Schuster to Niemeyer, 19 Jan. 1930, Bank of England Archives, London [hereafter BOE], Gl/411; C. Markovits, *Indian Business and Nationalist Politics, 1931-39: The Indigenous Capitalist Class and the Rise of the Congress Party* (Cambridge, 1985), pp. 46-7, 93.

8 For example, see M.J. Daunton, 'Financial Elites and British Society, 1880-1950', in Y. Cassis (ed.), *Finance and Financiers in European History, 1880-1960* (Cambridge, 1992), p. 141.

consists, at one level of a series of short-term policy interventions. Historians have been as bemused by short-term phenomena as economists. Moreover, by looking at economic management in inter-war India as purely short-term and *ad hoc* interventions, historians of India have tended to miss the longer-term pattern to these interventions Unearthing the longer-term pattern of policy interventions in India and examining the possible political and institutional implications of such a pattern would contribute to a better understanding of the economic and political history of the final decades of Britain's rule over her most important colony.

As an idea, economic management is of relatively recent origin. Associated with the so-called Keynesian revolution and the weakening of a fixed set of ideas about the virtues of balanced budgets in economies with external payments controls, it came into its own in the more open economies of the real world with the crumbling away of fixed exchange rates in the early 1970s. With these two developments, particularly the latter, what had earlier been important policy objectives: balancing the budget and maintaining a given external parity, ceased to matter to the same extent. In ceasing to matter as objectives, moreover, fiscal and exchange rate policy became important instruments of short-term policy adding to the limited effectiveness of an arsenal which had earlier been comprised chiefly of monetary policy instruments. In addition, in many parts of the world today, supply management represents an important aspect of short-term policy-making, particularly in relation to general or sectoral inflation.

As with other arsenals today, that of the modern economic manager is overflowing in comparison with the situation that generally prevailed say sixty years ago. I say 'generally', since a number of countries have in the past experimented with economic management and deployed a wide array of policy instruments in the process. Depression-hit Brazil disengaged itself from the world economy and followed a more activist policy (including exchange-rate depreciation, large-scale deficit-financed public expenditure, price-stabilisation schemes), for example, than France or Belgium which remained nailed to the gold standard until the mid-1930s. Such examples can be multiplied indefinitely, so that in some senses, while the idea of economic management is of relatively recent origin, its practice has a longer history.

Economic management is usually understood to be motivated by the objective of preserving the economy in a state of equilibrium, however the latter is defined, or restoring it to that state following a displacement from it.[9] The displacement might be due to large or small shocks originating at home or abroad or arise as a consequence of what, without any attempt at definition, might best be loosely termed 'economic dynamics'. This three-fold distinction – between relatively smaller, say seasonal, shocks, large shocks, and ordinary

9 The decision as to what constitutes an 'equilibrium' at a given point of time is often, of course, a political one.

movements in economic indices away from some desired equilibrium configuration – helps sharpen the focus and enables us to regard economic management somewhat more widely, and incidentally with greater historical accuracy, than contemporary practice allows. Ordinary disequilibria were not only smaller, they were also thought to be more susceptible to automatic self-correction, though the extent to which this took place (or was allowed to take place) is open to debate. A large shock, in contrast, could knock an economy off its accustomed moorings, say a fixed parity with gold, as happened with Britain and the pound sterling in September 1931, and whether so intended or not, create some room for economic management. Alternatively, it could be intense enough to make it difficult, if not impossible, for the country receiving the shock to withstand it without securing for itself greater freedom of economic manoeuvre or management, usually by jettisoning constraints such as fixed external parities. While economic management could be counter-cyclical as in the above two cases, it could also be pro-cyclical in its response to a large shock and be designed to adjust the economy to the shock, often by intensifying its primary effects. This is an important historical aspect of economic management which risks being ignored in conventional, more contemporary, definitions of the term. In addition to this, we might also identify a form of 'colonial economic management' which concentrated on transferring to the colony the effects of a shock or of shocks sustained by the metropolitan economy, or intensified the shock(s) sustained by the colony in order to assist recovery in the metropolitan economy.

IV

Historically, India is regarded as a pioneer of economic management since the later part of the nineteenth century. The last quarter of the nineteenth century is associated globally with the gradual decline of silver and bimetallic standards and the consolidation of the gold standard. As is well known, India was on a silver standard until 1893. During the two preceding decades, falling silver prices had led to the rupee depreciating from a shilling and about ten pence to a shilling and about three pence.[10] This created a series of problems – budget deficits run up to meet external obligations fixed in gold and higher taxes, for example – and opportunities, particularly for the exporting and the emerging import-substituting sectors of the economy. Consequently, the shorter-term economic implications of the fall in silver were never far from public attention, particularly as the crisis in the market for the metal intensified in the 1880s. These implications were also debated between interest groups, for example civil servants having expenditure commitments in sterling but having salaries and pensions fixed in rupees, planters exporting tea, and manufacturers exporting cotton and jute or flourishing in the protectionist environment created by a depreciating rupee. The colonial state too was an interested party, staffed as it as by officials struggling to balance both household and government accounts.

10 S. Ambirajan, *Political Economy and Monetary Management, India: 1860-1914* (Madras, 1984), p. 99.

No one apparently was above the fray at this time in India, so that there was no authoritative voice, or for that matter silence, to distract attention from contentious shorter-term issues.[11]

Authoritative voices in London counselled non-intervention. But there were obvious practical limits to the willingness of a government, which was having to mobilise additional revenues to service its sterling obligations, to listen to such advice. According to the logic of the non-interventionist argument, currency depreciation would trigger domestic inflation which, among other things, would boost the government's nominal revenues sufficiently to offset the higher rupee cost of servicing the foreign debt. Once this happened, equilibrium (or more accurately *status-quo ante*) would be restored, albeit at higher prices and higher nominal values. But a substantial proportion of the colonial government's revenues (for example land revenue) was not inflation-elastic in the near-term. In any event, it would have been imprudent for the government to risk further currency depreciation by running a budget deficit, however transitional that might be, to finance its external obligations. Therefore, turning its back on the logic of non-interventionism, the colonial government raised taxes to mobilise the bulk of the additional rupee resources it required to service external obligations, and incidentally also to offer better rates of exchange for civil servants wanting to remit salaries and pensions home. With silver prices showing no signs of stabilising, the Indian government once again departed from a non-interventionist stance, coming round to supporting the idea of a coordinated international solution to the silver problem. However, international efforts to stabilise silver made little headway. In the meantime, the limits to screwing up taxes out of the Indian economy were also being approached. With prospects growing of America also abandoning silver and sending the metal crashing, authorities in London and Calcutta decided finally in 1893 to close the colony's mints to the free coinage of silver.

The counsel for non-intervention emanated not only from London. Recognising that the rupee's depreciation held the promise of boosting Indian industry, prominent Indian economists and publicists such as Dadabhai Naoroji, R.C. Dutt and Dinshaw Wacha, also urged the government to let things be. The silver problem, and with it the problem of rupee depreciation, they appear to have felt, would resolve itself if only the authorities in London made no attempt to interfere in the market for rupees by overselling council drafts. Indian economists opposed the closing of mints to the free coinage of silver as

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11 India's gradual drift towards the gold standard forms part of a rather large literature. See A.P. Kaminsky, 'Lombard Street and India: Currency Problems in the Late Nineteenth Century', *Indian Economic and Social History Review*, Vol. 17 (1980); E.H.H. Green, 'The Influence of the City over British Economic Policy, c. 1880-1960' in Y. Cassis, (ed.), *Finance and Financiers in European History, 1880-1960* (Cambridge, 1992); D. Rothermund, 'An Aspect of the Monetary Policy of British Imperialism', *Indian Economic and Social History Review*, Vol. 7 (1970); S. Ambirajan, *Political Economy nnd Monetary Management*, chs. 6-8; and A.K. Bagchi, *The Presidency Banks and the Indian Economy: 1876-1914* (Calcutta, 1989), ch. 1.

deflationary and violative of all existing contracts between the government and its creditors.[12]

After 1893, the government of India began to concentrate upon ensuring that the rupee would appreciate to the 16d. rate recommended by the Herschell Committee. Although to begin with the government was more successful in placing a cap on the rupee than a floor below it, before long it succeeded in creating enough monetary stringency to force the rupee up to 16d. at which rate the Fowler Committee recommended its stabilisation in 1898. The Fowler Committee also recommended the establishment of a gold standard for India. But with fears of a global oversupply of gold evaporating by the turn of the century and Britain herself beginning to face recurring shortages of the metal, opinion in London grew opposed to the establishment of a gold mint and the circulation of gold currency in India. Consequently, the colony was left to evolve, more by accident than by design, a version of the gold standard in which the rupee was pegged to gold but where the latter metal did not circulate as part of domestic coinage. In addition, sterling replaced gold as the principal medium of external intervention to stabilise the rupee, and the latter's parity with respect to gold was now largely preserved through purchases and sales of sterling. The gold exchange standard, as this version of the gold standard soon came to be called, inaugurated a new phase in India's currency system, lasting until the First World War, whose central feature was that of restricting the use of gold as money in India.[13]

Contemporaries in India and Britain regarded the gold exchange standard as a 'managed' system, which did not function in the same 'automatic' way as a 'pure' gold standard. This criticism was wrong in one respect and right in another. Most contemporaries viewed the nineteenth century gold standard as functioning through spontaneous, self-correcting specie flows, the export of gold by the deficit country to the surplus country triggering contrary movements in the money supplies of the two countries. The spontaneous erosion or accretion of a country's gold reserve and the latter's link to money supply was also believed to act as a check on governments' capacity for monetary inflation.[14] As Keynes was among the first to recognise, the nineteenth century gold standard did not function in this way. First, payments disequilibria 'merely led to a reshuffling of British bank deposits' rather than actual movements of gold.[15] Second, and more importantly, countries adopted

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12 S. Ambirajan, *Political Economy and Monetary Management*, chs. 6-8.

13 For accounts of the working of the gold exchange standard, see E. Johnson, and D.E. Moggridge (eds), *The Collected Writings of John Maynard Keynes* [hereafter JMK], Vol. 1, *Indian Currency and Finance* (London, 1971); for accounts of its historical evolution, see M. De Cecco, *Money and Empire: The International Gold Standard, 1870-1914* (Oxford, 1974); and Ambirajan, *Political Economy and Monetary Management*, ch. 8.

14 This superstition, incidentally, continues to be held by many people on the extreme right, particularly in the United States.

15 The expression is from R. Triffin, *Our International Monetary System: Yesterday, Today, Tomorrow* (Princeton, 1962), p. 8.

several means to arrest the erosion of their gold reserves or boost them at the expense of others. These ranged from manipulating interest rates, sometimes asymmetrically (raising them when there was a payments deficit but not lowering them when there was a deficit), to simply not letting gold go by placing informal physical barriers or financial disincentives in the way of exports of the metal. So that, contrary to the conventional understanding, the gold standard remained a 'managed' system in significant respects. Consequently, it might be inappropriate, as Keynes underlined, to distinguish the gold standard from the gold exchange standard on the ground that the former was an 'automatic', and the latter a 'managed', system.[16]

Yet. in important respects, the gold exchange standard held greater potential for management than the gold standard. Apart from the instruments which countries on the gold standard used to regulate movements of gold, the gold exchange standard in the colonial setting gave authorities in London an useful additional tool which they used with great effect to restrict gold movements to India. This was the Secretary of State's power to offer in the market instruments for transferring funds to India at prices which undercut gold exports as a means of remittance to the colony. Depending on which instrument he entered the market with, the Secretary of State could not only prevent gold flowing out of London, but also divert to the latter centre consignments of the metal intended for India from Cairo, Colombo, or even from Western Australia. On the face of it, and in several respects in reality as well, the council bill mechanism (which is used here as a shorthand expression to represent the different instruments of remittance the Secretary of State could offer in the market) functioned little differently from a system where remittances took the form of gold movements. Indeed, the former supplemented gold movements rather than replaced them altogether. This for two reasons: firstly, officials in pre-war London attempted to regulate gold flows to India, not stop them completely. Secondly, their success in choking off gold exports to India was limited since operators in the market were often quicker to exploit potential intermediation margins in the gold, currency, and money markets at different centres than the Secretary of State's financial advisers were in spotting or offsetting them. Whatever the extent to which agents wishing to remit funds to India succeeded in attenuating the intended effect on gold exports to the colony of the council bill mechanism, their decisions could not have been unaffected by the potential that existed of the Secretary of State intervening in the market for rupees the following week at prices which made the arrangement they finalised today to land gold in India look silly. How far the existence of the council bills mechanism, rather than its actual deployment, affected the remittance decisions of economic agents has not been studied. But its effects, one ventures to guess, would not have been inconsiderable.

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16 *JMK*, 1, pp. 11-19.

A further aspect of the council bills mechanism was that it confined remittances to a clutch of London-based exchange banks. Other institutions which could have exported gold more cheaply to India than the exchange banks, particular to the colony's smaller ports, may have been inhibited by the absence of minting facilities and the thin spread of currency offices outside the major centres. Consequently, agents who played a major role in distributing currency to the interior or in financing internal or inter-regional trade tended to be short of funds in the peak harvesting season when they were most in need of liquid resources to finance procurement operations. One of the several implications of this relatively inefficient mechanism for currency expansion was that discount rates tended to shoot up during the peak season (running from October through March or April). In later years, this phenomenon brought the government forward as a lender of the last resort, and gave it another instrument of short-term management: when the government wished, for whatever reason, to rein in currency expansion in the peak season, for example, it refused to ease credit stringency in the market even when interest rates touched dizzying heights. Thus, the pre-war gold-exchange standard, despite functioning in ways that were analogous in most essential respects to the gold standard, afforded the authorities in London and India some additional scope for management which they were often not loath to exploit.

However, to preserve domestic price stability, for reasons that are discussed below, the latter objective came to occupy centre-stage in Indian economic management during the early and mid-1920s. From 1908, Indian authorities began to be concerned about what they felt was an unduly large rise in prices in the colony and their distributional consequences. Uncertain as to whether the phenomenon was due to external causes or to domestic factors such as an ineffectual monetary policy, officials in Calcutta sought an expert investigation into it by Alfred Marshall. The India Office smelled a rat in this suggestion, in the form of an implicit argument that the government of India was inhibited from effectively contracting currency in the absence of free inflows and outflows of gold and of gold coins in circulation. In opposing Calcutta's proposal for a price inquiry, the India Office took the view that inflation was a worldwide phenomenon that had been imported into India, and nothing the colony did could possibly be effective in arresting it.[17]

V

Governments around the world suspended liberal economic principles during the First World War, and India was no exception. As Western governments failed to mobilise adequate real resources for the war effort, they resorted to inflationary financing. The latter led, inevitably, to severe balance of payments problems. Britain was no exception. Although she was in the advantageous position of being able to pay for her imports from the empire in sterling IOUs,

17 See Ambirajan, *Political Economy*, pp. 165-7.

her trade imbalance with the United States became severe enough during the war to strain all her external financial resources to the utmost.

Britain's failure to mobilise adequate real resources for the war effort had repercussions on the Indian economy. While the former's demand for Indian exports increased rapidly, she lacked the means to pay for them except in the form of sterling securities. But this method of financing her exports was unsustainable from the point of view of the colony's monetary system which depended, for reasons that have been discussed elsewhere, upon regular infusions of silver coinage.[18] In general, during much of this period, neither gold nor silver was available to India in the quantities required to overcome the currency crisis, since importing these metals into the colony was thought to represent a wasteful diversion of the empire's scarce dollar resources. One possible path towards equilibrium lay through higher prices for Indian exports, achieved perhaps by means of a currency appreciation. But the latter was ruled out as it would have imposed an additional strain on British finances when the metropolitan economy's demand for the colony's exports was inelastic with respect to prices. (However, conditions in the silver market forced India's policy-makers to revalue the rupee in 1916 and 1917.) The only option left, under the circumstances, to the colonial government battling to contain a major currency crisis was to restrict the colony's exports to war necessities. This deflationary measure, adopted in 1916, proved inadequate to bridge the widening gap between the demand for precious metals in India, which was also being boosted by expectations of inflation, and their availability. The resulting crisis of the Indian currency system was not decisively overcome until a deflation in 1920-1 squeezed the demand for money in the colony. But it was managed for the duration of the war through export controls, controls on domestic and external trade in precious metals and on their movement within the country, and finally thanks to emergency shipments of silver from the United States treasury. India's external economic experiences during the First World War could be said to have held two pointers to the future: first, as Britain faced a liquidity crisis, India's access to precious metals would be restricted; and second, the colony would have to depress its own level of economic activity in order to make up for the economic imbalance facing the mother country.

VI

The First World War might be regarded as an exceptional situation, but the problems Britain faced during the war and the manner in which she attempted to resolve them foreshadowed, in important respects, several evolving features of the inter-war world economy. Having liquidated the bulk of her dollar securities, saddled with large war debts, her industrial structure in a state of

18 For details of the nature of this crisis and efforts to tackle them, see G. Balachandran, 'Finance Orientalism? Britain, the United States, and India's Wartime Currency Crisis, 1914-1918', *South Asia*, NS, Vol XVI, no. 2 (1993).

disrepair, and the traditional channels of her foreign trade either blocked or disrupted, Britain's economic troubles did not end with the war. Rather, they grew worse, as the postwar boom, to sustain which sterling was taken off the gold standard in March 1919, ended in 1920 and threw hundreds of thousands of British workers out of work. Thereafter, Britain faced the daunting task of restoring sterling to the gold standard at the pre-war parity and London's pre-eminence in the international financial system amidst high rates of unemployment at home and an unsettled external environment. As British policy-makers realised, these inherently conflicting objectives were resoluble only in an inflationary world economy; and second, only the Americans had the necessary wherewithal to promote the expansion of the world economy and thereby assist a gentle rise in world prices.

But India threatened to be in the way. The colony came out of the war with large sterling resources. The latter reflected, essentially, the pent-up domestic demand for manufactures, whose imports had greatly slowed during the war, and for precious metals, particularly gold whose flows into India had been reduced virtually to a trickle during the preceding years. With the Western post-war boom running on unchecked and controls on her imports of precious metals persisting after the war ended, India continued to accumulate sterling resources. This intensified her domestic currency crisis, which as stated above, depended for its stability upon regular infusions of precious metals, mainly silver, and enlarged the risks that freer trade in India could pose to the Western world stocks of gold. Hence, even as the Indian currency crisis intensified, the colonial authorities maintained checks on the colony's imports of gold. Controls of this nature were, however, extracting a heavy political price in India, and in general, administrators in London and Delhi came to recognise that the suspension of liberal trading principles could not be indefinitely sustained after the war without directly undermining the British stake in India.

On the other hand, these checks could not be withdrawn without serious consequences for the Western economies, and particularly for Britain. The latter could have tightened her belt further to generate a domestic surplus to offset her external disequilibrium, but in the wake of the post-war fears of Bolshevism, high rates of unemployment at home, and the urgent need for boosting industrial investment to restore capacity and increase employment, this was not practical politics. As Basil Blackett, who in 1920 was the Controller of Finance in the British treasury argued, India should not adopt a free gold import policy 'for an indefinite period', since it 'would have ... serious consequences (for) the currency systems of the United Kingdom, the British Empire, and indeed of the whole world ....' The British government's policy, Blackett pointed out, was 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 ... [was only half the pre-war level], 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.[19]

The only lasting solution to the problem which India posed to British policy-makers was that of inflicting a sharp deflationary shock to her economy that would force households in the colony to liquidate their savings to finance essential consumption rather than buy gold. With the 'edge of India's appetite for gold' thus removed, controls on gold movements to the colony could be lifted and a freer trading regime introduced without threatening Britain's hopes of returning to the gold standard.[20]

A deflationary shock of the magnitude needed to suppress India's demand for gold could not, however, be justified to the public in terms of the compulsions facing the metropolitan economy without gravely endangering the colony's faith in its rulers. Hence it became necessary to provide the policy with a 'line of defence from the popular point of view', particularly in India.[21] Consequently, officials in London began an exercise to cloak Britain's inter-war 'bullionist' attitudes toward Indian monetary and exchange rate policies in the neutral discourse of 'liberal' economic policy, and shroud them in a mystique which has succeeded in defeating modern historians more effectively than it deceived knowledgeable contemporaries.

It was Keynes, who in more senses than one, pioneered the new discourse of Indian economic policy. In his *Indian Currency and Finance*, he had pointed out that India's demand for gold rose in a global boom and helped check it. Conversely, it fell or turned negative during a slump. Keynes' influence was already evident in some of the memoranda prepared for the Babbington-Smith Committee by officials at the India Office.[22] But while learning to diagnose the nature of India's gold appetite, they stopped short of using it as a prescription for a cure. Keynes, who met the Babbington-Smith Committee when it was in the middle of examining the possibility of revaluing the rupee steeply to enable India to buy silver and keep off gold, told the committee that it should justify the revaluation proposal as an attack on inflation in the colony, and not as a means of diverting its demand for metal away from gold, although the latter outcome too would inevitably follow.[23]

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19 'Indian Exchange and Currency Committee', Blackett's memorandum, undated, but 18 Dec. 1919, Public Record Office [PRO], T160 18/F.571; R.G. Hawtrey also made the same argument: see his memorandum, 'Indian Exchange and Currency Committee: Draft Report', 17 Dec. 1919, in the above file.

20 The quote is from India Office Records [IOL], L/F/7/612, 'Note on the Currency Situation', 17 Oct. 1920, by H.F. Howard.

21 The quote is from Keynes' evidence to the Babbington-Smith Committee (Committee on Indian Exchange and Currency, 1920), Q. 2679.

22 See for example, Babbington-Smith Committee, Memoranda and Evidence, 'Memorandum C' and 'Supplement to Memorandum C', both by Frank Lucas, Financial Secretary in the department.

23 The 1920 stabilisation episode is discussed in G. Balachandran, 'Britain's Liquidity Crisis and India, 1919-20', *Economic History Review*, NS, Vol. 46, no. 3 (1993).

Keynes' intervention not only influenced the course of the Babbington-Smith Committee's deliberations, it put a stamp thereafter on the language of economic policy discourse in the colony and on the manner in which the London authorities represented monetary policy issues. Inflation, or the threat of it, became, almost overnight, the most important economic policy problem in India. It was advanced not only, as Keynes proposed, to explain the steep revaluation of the rupee in 1920, but also to justify the adoption of a regime of flexible exchange rates in the colony during the first half of that decade. The objective of the latter policy was to insulate the colony's economy from global inflationary pressures.

In adopting the policy of exchange rate flexibility to stabilise domestic prices, India was negotiating the contemporary frontiers of economic management. Keynes also commended India, not without reason, for having 'pioneered' the use of exchange rate management to achieve price stability.[24] But it is important to enter a few qualifications here. First, preserving stable prices in India was not an end in itself for British policy-makers. Rather, they believed India's demand for gold rose whenever prices were high, while it fell during times of stable or falling prices. As pointed out above, Keynes himself was one of the first to put this argument across.[25] Others in London, including, Ralph Hawtrey, Director of Financial Enquiries at the British treasury, and Cecil Kisch, Finance Secretary at the India Office, took up the refrain during the 1920s.[26] Converts to the unorthodox idea of floating the rupee to stabilise Indian prices and reduce the colony's gold imports included Montagu Norman, the redoubtable Governor of the Bank of England, who is usually regarded as the high-priest of contemporary monetary orthodoxy.[27] But Keynes' advice to manage sterling to stabilise domestic prices fell on deaf ears in Britain during the 1920s, as the country's economic administrators, with Montagu Norman himself in the lead, set the economy on a grim path towards deflation. The unorthodox policy of exchange rate management to stabilise prices did not also become a permanent feature of economic policies in India, and price stability remained an attractive objective only in a climate of rising world prices. As prices in India crashed during the depression officials refused steadfastly to manipulate the exchange rate to stabilise Indian prices. Indeed, they went further to write the colony's exchange rate into the statute books in 1933-34, when the depression as measured by the fall in retail prices in India was at its height!

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24 *JMK*, IV, *A Tract on Monetary Reform* (London, 1971), pp. 127-8.

25 *JMK*, 1, pp. 70-1.

26 'Return to Gold Standard', July 1920, Churchill College Archives, Cambridge, Hawtrey Papers, Htry 1/13; Royal Commission on Indian Currency and Finance (Hilton-Young Commission), 1926, *Minutes of Evidence*, QQ. 11036-41; R.G. Hawtrey, *The Gold Standard: In Theory and Practice*, fourth edition (London, 1939), p. 56.

27 Hilton-Young Commission, *Minutes of Eviclence*, QQ. 13724-34; BOE, OV 56/52, undated note by Norman attached to the minutes of the meeting of the London Advisory Committee of the Imperial Bank of India, 16 Mar. 1925.

VII

There can be little doubt that Indian short-term economic management in the 1920s was motivated largely by the objective of regulating the colony's access to gold. Until the mid-1920s, Britain sought an expansionary world economy to reconcile the conflicting objectives of reducing unemployment at home while ensuring that sterling returned to the gold standard at its pre-war parity with gold. After 1925 sterling's survival on the gold standard depended on an expanding world economy. Britain's ability to stimulate a global economic boom was limited during these years, since an increase in domestic investment and expenditure tended to weaken sterling rather than boost world prices. A weak sterling and an unstable external account also prevented Britain from lending abroad on the same scale as before the war. Under these circumstances, Britain's hopes of a global economic expansion and a relatively painless return of sterling to the gold standard depended on the American ability and willingness to sustain rising levels of activity at home at the same time as lending liberally abroad.

However, the Indian appetite for gold was thought capable of arresting any expansionary stimuli that the world economy might experience. As world prices and levels of economic activity rose, Indian exports and incomes would also rise. Not only would Indian households have higher disposable incomes, but they might be tempted by higher commodity prices to move into precious metals (largely gold in the 1920s since silver prices tended to fall or remain unsteady after peaking in 1920) as a hedge against inflation. In the years immediately preceding the war, the colony had shown itself capable of absorbing between a fifth and a quarter of the world's output of gold. A repetition of this performance in the 1920s was feared to spike any possibilities of a sustained expansion of the world economy, more so as gold holding increased in significance in the inter-war international monetary system following the weakening of traditional reserve currencies such as sterling, the French franc, and the German mark.

Although India's economic administrators made strenuous efforts to regulate the colony's imports of gold, for reasons that need not detain us here, their success remained mixed during the mid-1920s. But these efforts came into their own in the depression of the 1930s. The converse of Keynes' understanding of the determinants of Indian gold absorption which became a basis of policy was that while the colony would import gold in a world boom, it would reduce such imports or even export the metal in a slump. The objective of ensuring that Indian gold exports and imports were regulated in the interest of the international economy consequently yielded an asymmetric policy prescription for the colony. Not surprisingly, in the circumstances, the accent of policy in India during the depression became one of deflating the economy further to enable it to finance the capital flight that originated in fears for the stability of sterling and of the rupee. Pleas from Indian businessmen and bankers, and even from some officials of the government of India, to ease the

deflationary response to the depression fell on deaf ears as London was intent on ensuring that the colony paid its own way during the crisis. As prices and incomes slumped, Indian households began liquidating their savings held in the form of gold and silver to settle their debts, meet fixed obligations such as land revenue claims, and support consumption. As the currency offices of the government of India filled up with enormous quantities of gold, and to a lesser extent of silver, London began pressuring Delhi to export gold to Britain, no doubt to restore India's official foreign exchange reserves which had fallen as a result of capital flight from the colony. However, before such gold exports could materialise, sterling itself was forced off the gold standard in September 1931. The depreciation of sterling, the continued outpouring of gold by Indian households, and the resulting divergence between gold prices in India and abroad led to the colony exporting nearly two hundred and fifty million pounds worth of gold between 1931 and 1938. As contemporaries, including Keynes, noted, from being a 'bottomless sink' of the precious metals, India was transformed into a major expansionary influence upon the world economy. The policy that London had initiated for the colony in 1920 was once again bearing fruit, now in unexpected profusion.

VIII

India's counter-cyclical role in the international economy and Britain's inter-war bullionist attitudes created the necessity for the colonial power to take a close interest in managing the colony's economy. At a wider and more general level, Britain's policy objectives in relation to India during these years can be understood partly as an effort to transfer to the colony some of the burden of adjustment the metropolitan economy was required to undertake to eliminate the domestic and external disequilibria facing it. In general, inter-war Britain attempted to externalise these burdens to the extent possible. The expectation Britain nursed in the 1920s of a USA-led inflation of the world economy reflected the hope that her project of restoring sterling to the gold standard at the pre-war parity would be accomplished on the back of a global inflation rather than solely or principally through deflation at home. However, in order to sustain the world economy on an expansionary course it was necessary to insulate the Indian economy from it and prevent the colony's households from experiencing a rise in prices and incomes that might encourage them to step up their absorption of gold. To some extent, therefore, one might argue that India's economic policy-makers inflicted on Indian households the burdens of adjustment (in the form of reduced income and output or their lower rates of growth) that Britain remained reluctant to undertake to restore sterling durably to the gold standard at the pre-war parity.

There was an important difference between the extents to which Britain could persuade the United States and India to play the roles she assigned to them in the early phases of the inter-war economy. Except for a few years in the mid-1920s, the United States was reluctant to be the 'locomotive' that

would lead the world economy out of the slump. Impatient as Britain was with America's halting and lukewarm response to her pleas for coordinated action to tackle the global crisis, there was little she could do to persuade her Atlantic ally to play a more activist role. Britain's policy-makers even considered exporting gold to the United States to set the desired expansion in motion. The plan was abandoned when it became clear that it would have no tangible impact on American policy, but the fact that it was debated seriously at the highest levels in the British economic policy establishment gives us some idea of the desperate situation to which Britain was reduced during these years in her dealings with the United States.

The leverage which Britain possessed, and exercised, over macro-economic policy-making in India contrasts sharply with the limited influence she possessed over American policy-making. This leverage was embedded, undoubtedly, in India's colonial relationship with Britain. Where they extend to policy, traditional analyses of the colonial relationship might focus, at best, on trade or tariff policies. On the other hand, an important feature of open 'peripheral' economies since the late-nineteenth century, particularly when they were colonies of the most successful colonial power of the period, was that they also shared a hierarchical macro-economic relationship with the latter. Now hierarchy is the unstated given when one talks about colonialism, and the nineteenth century world economy represented, by common consent, a hierarchical setting. But the analysis of hierarchy in this context focuses usually on aspects of the structure of the world economy, rather than the relations which help realise it. In the case of India, for example, the structural hierarchy of the pre-war international economy was partially realised by Britain exerting formal or informal, but always effective, control over the most significant aspects of economic policy-making in the colony.

The analysis presented here of macro-economic relations between India and Britain is not altogether new or of recent origin. Its seeds can be discerned in the writings of contemporaries, for instance in the memoranda of the Economic Advisory Council in the 1930s.[28] Indeed, Saul's analysis of the role that the empire, notably India, played in enabling Britain to settle deficits with the rest of the world and De Cecco's analysis of the functioning of the pre-war gold standard are located in an implicit macro-economic setting that is relationally similar to the one addressed in this essay.[29] Although few imperial economic historians could afford to ignore Saul's findings, it was always

28 See, for example, 'International Trade, the Price Level and the Gold Problem', Committee on Economic Information, 23rd Report, Oct. 1937, part 2, T160/77, f. 15583, PRO.

29 S.B. Saul, *Studies in British Overseas Trade, 1870-1914* (Liverpool, 1960); De Cecco, *Money and Empire*.

unclear how they fitted into the familiar frameworks of imperialism.[30] Likewise, De Cecco's work on the pre-war cold standard was used widely by students of imperial financial arrangements, but it has never properly been integrated into mainstream interpretations of the economic relationships characteristic of colonialism, which continue predominantly to emphasise the role of colonies as destinations for metropolitan finance or capital, and manufactures. Hence it might be useful to relate the analysis presented here to those of Saul and De Cecco, and in doing so, cast the argument of which this essay is a part in a somewhat more general light.

IX

A possible approach to extending Saul's pioneering work is to regard India and other similarly placed colonies as unequal parts or enclaves of the British macro-economy. This possibility emerges from the fact that this enclave held its net savings, payments surpluses, in the form of sterling and gave up whatever dollars (or gold) it earned to Britain.

In the world described by Saul and De Cecco, India earned Britain's dollars (and her pounds) by exporting commodities to the rest of the world. Exports, as everyone knows, represent savings. In other words, India had to save, postpone investment and consumption in order to accumulate sterling in London. Now consider the situation from London's point of view. A portion of her dollar needs are met by savings in India, and her own households and firms do not therefore have to make the adjustments to consumption and investment needed to finance imports from (what we shall simply call) the dollar area. On the other hand, it might be argued, Britain's households and firms would have to save in order to export to India commodities in return for the dollars that the latter placed at Britain's disposal. To some extent this is true even if one wishes to mutter darkly here about market imperfections and monopoly rents.[31] But, and this is an important qualification, if India agrees to accumulate sterling credits, Britain does not have to produce surpluses for export to the colony to pay for the dollars yielded up by the latter. So that, under these conditions, the colony not only eases the metropolitan economy's external (dollar) constraint, by agreeing to hold sterling securities, it also contributes to easing a domestic expenditure constraint within Britain.

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30 Consider here A.G. Frank, 'Multi-lateral Merchandize Trade Imbalances and Uneven Economic Development', *Journal of European Economic History*, 5 (1976); A.J.H. Latham, 'Merchandize Trade Balances and Uneven Economic Development in India and China', *Journal of European Economic History*, Vol. 7 (1978); and S.S. Pollard, 'Merchandize Trade and Exploitation', *Journal of European Economic History*, Vol. 6 (1977).

31 Such arguments are not entirely fanciful. Unlike Indian exports to Britain, a significant proportion of British exports to India would not have found markets in the United States. This reinforces the point made earlier about the advantages of treating India, for macro-economic purposes, as a part of the British economy.

The use of a counter-factual example will help illuminate the argument more clearly. Suppose the Indian government had decided to hold only dollars. Britain would then have had to slash imports from the colony or boost her exports to it. This may not have posed a major problem in itself, since the colony ran a deficit with Britain. But since the latter depended upon India for her supply of dollars, she would have been forced by the Indian decision to increase her own exports to the dollar area or reduce imports from it. Given the limited range of goods in which Britain was internationally competitive even before 1913, she would not have found it easy to increase her exports to the United States. In any event, the process of restoring a semblance of external equilibrium in the changed situation would have severely dislocated the British economy and depressed incomes and living standards through out the country.

The fact of India being part of Britain's macro-economy had other implications as well. Apart from participating in a common currency area, the sterling area, the colony also comprised a distinct sub-currency area, the rupee area. This created complications and opportunities. A possible complication, for example, was that while the Indian government might, without much ado, invest its assets in sterling, Indian households might express their lack of confidence in the currency by abandoning rupees for gold. Policy in India had, therefore, to be sensitive to the long-term risk that her households could pose to the future and stability of sterling via the market for rupees. On the other hand, India's economic policy-makers had the possibility now of manipulating the rupee's exchange rate to selectively disengage the colony's economy from trends and movements in the international economy or, alternatively, intensify their impact should that be necessary, and using such manipulations to check any move on the part of Indian households towards gold. This possibility, which could not have arisen in quite the same simple way if India had used sterling domestically as well, was utilised to good effect during the inter-war years. Rupee manipulation ensured, for example, that the boom of the 1920s 'virtually bypassed India';[32] and that the depression would wreak greater damage in the rural areas than it need otherwise have done.

It might be argued and validly enough, in opposition to the above, that holding reserves in the form of sterling was not peculiar to the imperial relationship. It was a feature of the gold exchange standard which had adherents outside the empire; and indeed the gold exchange standard survived without any obvious imperial trappings under U.S. leadership for over two decades after the Second World War. The answer to this argument is two-fold. First, the imperial basis of the gold exchange standard, as Marcello De Cecco showed, is often under-estimated.[33] While the gold-exchange standard managed to survive without any obvious imperial connection during the 1950s and the 1960s, the postwar circumstances were rather special. It is not self-evident that a gold exchange standard would have come into existence in the late nineteenth

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32 The phrase is from D.H. Aldcroft, *From Versailles to Wall Street, 1919-1929* (London, 1977), p. 216.

33 De Cecco, *Money and Empire*, esp. ch. 4.

century world used to metallic money but for the clutch of colonies which were tied to sterling. Lindert's analysis of the hierarchy in the movement of funds between financial centres implicitly supports this view.[34] Second, under the text-book gold-exchange standard, the key-currency centre (Britain earlier and subsequently the United States) did not directly control the economic policies of countries whose currencies were pegged to the key currency (sterling or the dollar). In the imperial gold exchange-standard, in contrast, besides India investing surpluses in sterling, Britain's control over economic policies in the colony enabled her to exercise considerable influence over the levels of economic activity there and consequently the surpluses it would generate. Thus, reverting from the general to a variant of the particular relationship sketched by Saul, once India ceased producing the spontaneous convertible surpluses that had helped lubricate Britain's pre-war payments network, the latter began to devote attention to other ways of ensuring that India continued to underwrite a broadly unchanged pattern of settlements. The necessity of doing so increased during the inter-war years, since Britain's competitive position in the international markets was even weaker at this time than before the war and she could not, for economic and social reasons, afford to restructure her industry rapidly enough. Faced with a severe weakening of her external position and the diminution in the contribution India made to easing it, Britain responded at first with a form of defensive intervention that was intended to ensure that the colony's lower dollar earnings (in relation to Britain's dollar requirements rather than in absolute terms) was offset by its lower demand for dollars (or gold). During the depression, however, the British intent became rather more aggressive, with the metropolitan economy attempting successfully to manoeuvre the Indian economy into a position of supporting its balance of payments, this time by exporting gold.

X

The latter interpretation is obviously at odds with the interpretation offered in accounts of inter-war relations between Indian and Britain which argue that following World War I, the British government decided upon a policy of gradual disengagement from India, and that to this end, it followed a policy of granting the colony self-rule or autonomy over a growing number of areas. Whether or not this argument holds in respect of British policy towards India in general, it must be evident that it is unsustainable in relation to control over the colony's monetary policies. According to Gallagher and Seal, the process of granting India monetary autonomy was buffeted by short-term uncertainties. The 1920s, according to them, saw India gaining more powers, but the process was reversed during the great depression when Britain 'steered' India with a 'firm hand on the helm'. Once the worst of the depression was over, Indian

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34 P.H. Lindert, *Key Currencies and Gold, 1900-1930*, Princeton Studies (Princeton, 1969), p. 34.

opinion was supposed to have had its 'revenge' in the form of an autonomous Reserve Bank of India which came into existence in 1935.[35]

The above argument about a gradual, though not smooth, devolution of powers to India in the monetary arena is derived from similar movements in other spheres. The historical evidence, upon which this argument is imposed, is open to a contrary, and more valid, interpretation: Britain did not cede control over monetary policy to authorities in India until the political, military, and financial developments of the Second World War made such control difficult, if not impossible to exercise. To extend the argument advanced in this essay and spell out the political findings of the research upon which it is based, the deflationary consequences of the monetary and exchange-rate policies London forced upon India won the latter's government few friends in the colony. As opposition from local businessmen intensified, the threat grew of monetary controversies becoming politicised. As monetary policies and institutions were sucked into the vortex of political controversy, policy-makers in London began to apprehend that the case for their control over these policies might become difficult to justify.

In notable contrast to the transfer of powers over tariff policies in India, London was determined to retain her powers to make the colony's monetary policies. However, from the mid-1920s, authorities in London, particularly at the Bank of England, grew convinced that their control over the colony's monetary policies could not be sustained unless the latter were 'de-politicised' and entrusted to a body resembling a central bank. The objective of setting up a central bank in India also snugly fitted the Bank of England's agenda of resisting populist pressures for expansionary policies in the inter-war economy by carving monetary policy-making powers out of politically vulnerable government departments and placing them in the charge of 'apolitical' central banks.

However, efforts to set up a central banking institution in India did not make much headway in the early years. The Imperial Bank of India, set up in 1921, was slow in equipping itself for the task. More importantly, the India Office was loath to yield its powers to a central bank-type institution. The Hilton-Young Commission (1926) recommended the establishment of the Reserve Bank of India, but as the cry for 'monetary nationalism' intensified in India and the colonial government appeared to waver in its determination to combat this cry, the Indian Office succeeded in playing upon London's fears to avoid giving up any of its powers immediately. The price of this compromise was that the India Office virtually submitted to the will of the Bank of England in regard to Indian monetary policies. The idea of setting up a central bank in India was revived during the early 1930s in the context of achieving a measure of constitutional reform in the colony. Not wishing to entrust powers over

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35 Gallagher and Seal, 'Britain and India between the Wars', p. 409; B.R. Tomlinson, 'India and the British Empire, 1880-1935', *Indian Economic and Social History Review*, Vol. XII, no. 4 (1975), pp. 374-7.

monetary policy to a 'responsible government', London insisted upon making 'currency' a 'reserved' or 'safeguarded' subject, to be entrusted to a 'white and sensible' rather than a 'black and political' Reserve Bank under the formal tutelage of the Bank of England. It was also expected that the bank's officers would 'for a long time to come, (be) men other than Indians'.[36] Coming into existence in these circumstances in 1935, the Reserve Bank of India functioned virtually as the eyes, ears, and limbs of the Bank of England until 1942, when the sudden death of its governor led to the appointment, over London's objections, of C.D. Deshmukh as the first Indian governor.[37]

XI

So, to conclude, what possible generalisations can one draw about the link between finance and empire in the three decades before 1947? There is now widespread recognition that Britain's external economic policies since the late nineteenth century were strongly influenced by service capitalists, in particular financiers of the City of London, and that the latter remained deeply interested in India during the inter-war years.[38] This recognition has weakened, to a great extent, the acceptability of the rather absurd view that Britain's withdrawal from her colonies was planned soon after the First World War and that its actual implementation mimicked the grand retreats so celebrated in text-books on military strategies.[39]

Yet even among those who reject the latter view and accept revisionist ideas about the role of the London financial interest in influencing British colonial policies, there is room for debate over the principal constituents of the imperial interest (or by implication the City's interest) in late colonial India. Most scholars who focus, in my view rightly, upon the crucial role played by the City of London in this period err in supposing that the inter-war City was only interested in ensuring punctual servicing by India of the debts she owed Britain.[40] In so erring, moreover, they appear implicitly to acknowledge the 'gradual decolonisation' argument which also tended to regard debt collection as the central objective of a retreating empire.[41]

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36 Waley's minute, 3 Apr. 1933, T177/16, PRO; Hopkins's 'Note on the View of the Financial Advisers', 29 Oct. 1932, T175/45, PRO.

37 The issue of monetary autonomy is discussed at greater length in G. Balachandran, 'Towards a "Hindoo Marriage"? Anglo-Indian Monetary Relations in Inter-war India', *Modern Asian Studies*, Vol. 3 (1994).

38 This view is set out at great length by P.J. Cain, and A.G. Hopkins, in their two-volume work, *British Imperialism: Innovation and Expansion, 1688-1914*, and *British Imperialism: Crisis and Deconstruction, 1914-1990* (London, 1993).

39 For examples of one version of the 'gradual decolonization' argument, see Gallagher and Seal, 'Britain and India'.

40 For example, both Chatterji, *Trade, Tariffs, and Empire*, chs. 7-9 and Cain and Hopkins, *British Imperialism: Crisis and Deconstruction*, ch. 8 reject the gradual de-colonisation argument, but emphasise the central role of debt collection in colonial priorities.

41 This argument is made in Gallagher and Seal, 'Britain and India'.

Although its importance should not be underrated, it is difficult to dress debt collection up as the principal imperial interest in inter-war India. For, inter-war Britain continued to lend money, if not on the same scale as earlier, to countries outside her empire. Besides, if one excludes defaults by post-revolutionary Russia, Britain's efforts to force the United States to re-negotiate war debts, and the thorny problem of German reparations, the danger of countries not meeting their external obligations did not seriously emerge during the inter-war years until the world economy went into depression. There is indeed a danger here that the debt collection story looks at the 1920s through lenses of the 1930s. Where India was concerned, moreover, debt servicing had ceased to be a financial problem by 1932, and by 1933 she had emerged as a small net lender to the rest of the world. Consequently, the nationalist demand to re-negotiate Indian debts grew more muted. Finally, while drawing welcome attention towards the central role played by London's international services sector and the privileging of finance in Britain's external priorities, the excessive emphasis upon debt collection reinforces the bilateral perspective common to studies of her financial relations with the colonies, sharply narrows the scope of the City's engagement with the empire, and helps implicitly to affirm the argument that Britain freely cast relations with her colonies in the same defensive mould as her relations with the United States between the wars.

Other conceptions of the role played by the empire in Britain's inter-war priorities exist. It has been noted that Britain's domestic crises between the wars and the serious erosion of her global economic and financial leadership recognisably enhanced the importance of the formal empire in metropolitan economic policy-making.[42] It has also been noted that, far from being liberal or anti-colonial, Britain's 'internationalist' response to the crisis of the 1920s was often based on her control over key resources in the empire – whether South African gold, Malayan rubber, or Mesopotamian oil.[43] The common theme running through British economic policies in these regions was that of drawing upon their resources to earn dollars, strengthen sterling cheaply, and restore its pre-eminence in the international Financial system. The same objectives lay behind Britain's efforts to deflate the Indian economy and minimise the drain she could place on the world's gold resources. The management of the economies of the empire in the inter-war period was thus, in some respects, an extension of the management of the pound sterling and of Britain's economic relations with the United States.

Similar considerations may be said to have resonated in the context of decolonisation as well. No doubt, the historical links between finance and

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42 J. Tomlinson, *Problems of British Economic Policy, 1870-1945* (London, 1981), pp. 106-7; Cain and Hopkins, *British Imperialism: Crisis and Deconstruction*, pp. 4-6.

43 R.T. Ally, *Gold and Empire: The Bank of England and South Africa's Gold Producers, 1886-1926* (Johannesburg, 1994); F.C. Costigliola, 'Anglo-American Financial Rivalry in the 1920s', *Journal of Economic History*, Vol. 37 (1977); M.J. Hogan, *Informal Entente: The Private Structure of Cooperation in Anglo-American Economic Diplomacy*, 1918-1928 (Columbia, 1977), pp. 160-85; J.H. Drabble, *Malayan Rubber: The Inter-war Years* (London, 1991), pp. 246-7.

politics weakened in the last few years of the British rule over India. Given the economic, financial, and not least ideological and political, consequences of the Second World War, it would have been surprising if that had not been the case. Britain's decolonisation decisions in her 'minor' colonies were related to her external financial agenda.[44] Retrieving a sterling area from the wreck of the empire and the Second World War was an important part of this agenda at least until the mid-1950s, since, despite American impatience, Britain hoped to manage postwar economic recovery and the restoration of her former political pre-eminence on the strength of such an area. Consequently, it could be argued that Britain's policy towards individual colonies depended on how best to secure their allegiance to sterling. This conception of the economic interests that were sought to be preserved or advanced in the decolonisation process is, in my view, consistent with the general drift of the argument of this essay about Britain's determination to ensure against India setting up an unmanageable drain on international liquidity (gold in the earlier period and dollars after the Second World War) and adversely affecting the interests of a crisis-ridden metropolitan economy.

India emerged from the Second World War, as she did from the first, with large sterling balances. In 1920, London managed to expend these balances in exchange intervention to defend an overvalued rupee. The policy could not possibly have been repeated a quarter of a century later. Further, the developments of the intervening years, not least British-Indian currency and monetary policies of the period, had so ranged local business and political opinion against her that Britain was left with little option but to formalise India's adherence to the sterling area on the relatively liberal terms allowed to the 'white' commonwealth. Given the importance which Britain attached to the colony's monetary affairs between the wars, it would be surprising indeed if this shift did not facilitate the end of formal British rule in India.

This view also finds support from the course of postwar negotiations between India and Britain over sterling balances. When these negotiations began in 1947-8, Britain's priorities lay in securing India's allegiance to sterling and the writing-off of a reasonably large proportion of her wartime debts (amounting to about 1300 million pounds) to the former colony. Britain managed to achieve a negotiated, but hidden, writing down of the debt through higher prices for her military stores and equipment left behind in India and capitalising the sterling pension commitments of the government of India at artificially low rates of interest.[45] Each of these moves would have raised hackles in India in normal circumstances, but were accepted and implemented, particularly in the background of the climate of distrust that existed between the

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44 G. Krozewski, 'Sterling, the 'Minor' Territories and the End of Formal Empire, 1939-1958', *Economic History Review*, Vol. 46 (1993).

45 For a good account of these negotiations, see B.R. Tomlinson, 'Indo-British Relations in the Post-Colonial Era: The Sterling Balances Negotiations, 1947-49', in A.N. Porter and R.F. Holland (eds), *Money, Finance and Empire: 1790-1960* (London, 1985), pp. 142-63; also see John Fforde, *The Bank of England and Public Policy: 1941-1958* (Cambridge, 1992), pp. 108-14, 249-56.

two countries, with relatively little controversy in the changed political circumstances.

A third British priority in the sterling balances negotiations can be traced back to the inter-war period. This was to minimise India's claim for dollars against the inconvertible sterling she possessed (the so-called 'dollar ration') and ensure, as far as possible, that the latter would be used only to finance the import from Britain of goods which did not have a market in the United States and which, therefore, could not be exported thither for dollars. Stipulations such as these too would have proved more contentious in the adversarial environment of colonialism than in one based formally on partnership and mutual responsibility between two, albeit unequal, powers. However, with Britain losing the direct control she had formerly exercised over the levers of monetary policy in India, the latter ceased to be as intimate a part of the British macro-economy. But India remained, on the whole, a faithful member of the sterling area, not appearing to have protested the sterling devaluation of 1949 even though it inflicted substantial losses on her sterling holdings, and keeping the rupee tied, in some measure, to a declining sterling through the next two decades. At the same time, the deflationary experiences of the inter-war years appear to have convinced India's policy-makers of the advantages of imposing trade and payments controls, rendering the economy less vulnerable to external shocks, and affording the possibility of diversifying its structure behind steep protective barriers.