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'FINANCE ORIENTALISM'? BRITAIN, THE UNITED STATES, AND INDIA'S WARTIME CURRENCY CRISIS, 1914-1918

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It is well known that, in several respects, her empire fought a major part of Britain's Great War.[1] India's contribution to the war by way of men and materials has been widely acknowledged, not least by the British government of the day. However, the direct impact of India's wartime role on her currency system, although eliciting some mention in accounts of the period, has not been examined at any length by modern historians. This impact is, of course, important for its own sake and because it prevented India from turning the war to her economic advantage in the way that Japan and the United States managed to. But it is also widely acknowledged that the First World War marked an important turning point in the history of the British empire, and in Britain's role in the world economy. The changing economic role of the British-Indian empire has also been speculated upon within this context; though mainly from the point of view of trade, historians have not hesitated to extrapolate these speculations to the area of finance.[2]

There are a number of problems with these speculations which are, typically, insufficiently distanced from the perspectives and viewpoints of rival protagonists, say, in the heated 'ratio and protection' (i.e. the rupee's exchange rate and tariffs) controversies of the 1920s and the 1930s. Secondly, in contrast to what is commonly found in studies of the pre-war years, these speculations rest on the 'Little Englander' assumption that inter-war Britain had exclusively bilateral concerns in relation to India, and that her external financial problems forced upon Britain a measure of disengagement from her colonies. Little attention is paid to the possibility that these problems may actually have compelled Britain to tighten her control over certain aspects of

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1 For a recent argument on the strategic role of the British empire during the war, see Avner Offer, *The First World War: An Agrarian Interpretation* (Oxford, 1989).

2 See I. M. Drummond, *Imperial Economic Policy, 1919-1939: Studies in Expansion and Protection* (London, 1974), and *The Floating Pound and the Sterling Area* (Cambridge, 1981); B. R. Tomlinson, 'India and the British Empire, 1880-1935', *Indian Economic and Social History Review*, XII, 4 (1975), pp. 337-80.

financial policy-making in important colonies such as India.[3] This narrowing of focus has been self-perpetuating, and has tended also to limit the range of sources used to study Indo-British financial relations during this period, and the way in which the sources are read. Moreover, in recent years, historians have come increasingly to recognise the importance of the City of London in Britain's economic, social, and political life since the middle of the eighteenth century. It is also now widely conceded that City concerns, rather than those of Manchester or Liverpool, drove British economic policy during much of the inter-war period.[4] Although the Indian empire was of vital importance to the City of London in a number of ways, there is little recognition of this in the literature. Indeed, so well have historians of India succeeded in partitioning Britain's economic and financial priorities in the colony from those in Europe and America that India's importance to the financial sector of the British economy before 1914 may also be on the verge of obliteration.[5]

The importance of repairing the neglect of inter-war Britain's wider financial concerns in studies of her relations with India cannot, therefore, be exaggerated. I have argued elsewhere that these concerns dominated British-Indian financial policy-making during the entire inter-war period, and underlay Britain's determination not to relinquish her control over the Indian monetary policy apparatus almost until 1947.[6] The First World War was a critical turning point in these respects as well, and the external financial problems Britain faced during the war and the manner in which she sought to resolve them foreshadowed several aspects of the adverse external financial environment which beset her policy-makers during the 1920s and the 1930s. The role which India played in helping to ease Britain's wartime financial crisis also foreshadowed the responsibilities which metropolitan policy-makers expected the colony to undertake during the entire inter-war period. As such, India's financial experiences during the First World War

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3 See S. B. Saul, *Studies in British Overseas Trade* (Liverpool, 1960), pp. 56-63; M. De Cecco, *Money and Empire: the International Gold Standard, 1870-1914* (Oxford, 1974), pp. 62-75 for samples of the 'prewar perspective'. See also B. R. Tomlinson, *The Political Economy of the Raj 1914-1947:* the *Economics of Decolonization in India* (London, 1979), p. 44 for an explicit dismissal of the importance of Britain's wider multilateral concerns during this period. The 'Little Englander' characterisation is used in J. Gallagher and A. Seal, 'Britain and India between the Wars', *Modern Asian Studies,* 15, 3, (1981), pp. 398-9, fn. 34.

4 Sidney Pollard (ed.), *The Gold Standard and Employment Policies between the Wars* (London, 1970); G. Ingham, *Capitalism Divided? The City and Industry in British Social Development* (London, 1984); for a recent interpretative survey of the literature, see P. J. Cain and A. G. Hopkins, *British Imperialism: Crisis and Deconstruction, 1914-1990* (London, 1993), chs. 2, 3, 4 and 5.

5 For example, see B. J. Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression* (New York, 1992), chs. 1 and 2.

6 G. Balachandran, 'Gold and Empire: Britain and India in the Great Depression', *Journal of European Economic History,* 20, 2, (1991), pp. 239-70; 'Britain's Liquidity Crisis and India, 1919-1920', *Economic History Review,* 46, 3, (1993), pp. 575-91; 'Towards a "*Hindoo* Marriage": Anglo-Indian Monetary Relations in Interwar India, 1917-1937', *Modern Asian Studies,* forthcoming.

throw light on important aspects of the colony's inter-war economic and political history.

India's wartime currency problems arose because of Britain's trade imbalances with the United States and the latter's refusal to accept sterling credits in return for her exports. Therefore, it is instructive to preface a discussion of India's monetary adventures during the war with a brief account of Britain's short- and medium-term external financing problems as they appeared to her policy-makers. The third and fourth sections of the paper discuss the effects of the war on Indian trade, the manner in which it was financed, and the domestic currency problems which resulted. The fifth section deals with the joint Anglo-American effort to tackle this crisis. The central argument of this paper and its implications for our understanding of India's inter-war economic history are summarised in the concluding section.

II

During the war Britain faced a ballooning overall trade deficit, and a shrinking surplus on her invisibles account. The former rose from £134 million in 1913 to £784 million in 1918, and averaged about £419 million during these years. So severe was the shock administered to Britain's normal commerce by the war, that even her trade with India went into a deficit of about £40 million by 1918. However, the latter was not an immediate major problem for Britain's policymakers, since the major part of it could be financed in sterling. Of greater immediate significance was the trade deficit with the United States, which grew from £112 million in 1913 to £507 million at its peak in 1918, and averaged about £385 million during these years.[7] It became vital to develop new methods of financing this deficit, especially since its size and India's own wartime surpluses with Britain meant that the colony would no longer be able to undertake its pre-war role of liquidating a large proportion of the mother country's dollar deficits.[8] But if Britain's strategic planners underestimated the duration of the war, her financial planners complemented the mis-judgement by failing to anticipate their dependence on the United States for war imports and for the external financing of the war effort.

The complacency was soon dispelled. Even as war clouds gathered over Europe, Britain's policy-makers decided to maintain sterling's *de jure* status as a convertible currency since, in the words of a leading joint-stock banker who had earlier opposed the idea, London's success in preserving a 'free market for gold' during the war would represent 'a financial triumph as

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7 Government of India, *Statistical Abstract for British India* (Calcutta, relevant years); B. R. Mitchell, *Abstract of British Historical Statistics* (Cambridge, 1962), pp. 284, 320-1.

8 For India's pre-war role, see Saul, *British Overseas Trade*, pp. 56-63.

important to the country as a great victory in arms'.[9] After the first few months of the war, during which the upset in the world's financial markets sent sterling to unprecedented levels, trade and economic fundamentals asserted themselves, and sterling began to slide. Hence, gold exports were discouraged in practice, and all private exports of the metal from Britain had ceased by June 1916.[10] With the 'gold points' expected to widen thanks to higher shipping and insurance charges, the pound was allowed to stabilise below the gold standard parity at $4.765. But with growing imports and a weakening sterling, Britain borrowed short-term funds from the American banking firm of J. P. Morgan and Company, repaying them from the proceeds of periodic longer-term loan issues in the New York market. However, as E. C. Grenfell, a partner in Morgan Grenfell which was J. P. Morgan and Company's associate firm in London, warned in the summer of 1915, '[American] banks no longer consider(ed) a British Loan attractive' because the 'reported quarrels of Ministers, Newspapers and English Generals ...' raised questions in American minds about Britain's ability to win the war. Her officials were advised, in a manner redolent of warnings from Wall Street investment banks to latter-day third world regimes, that unless they got their act together Britain would lose the European war in New York's financial district.[11]

Britain took several steps to raise gold (dollar) resources for the war effort, including that of 'commandeering' the empire's gold output. Britain also sold dollar securities in the possession of her nationals as a means of limiting her borrowings in New York.[12] The British authorities experienced greater difficulty with the London clearing banks than they did with the empire, but eventually succeeded in mobilising the banks' gold reserves.[13] These measures were, however, less than adequate, more so as the unexpected length of the war worsened Britain's external financial outlook and her dependence on the United States even as relations between the two countries entered a particularly cool phase.[14] As an inter-departmental committee noted, even after Britain gave up half the Treasury's gold

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9 Edward Holden's speech to the shareholders of the London City and Midland Bank; reported in the *Financial News*, 23 Jan. 1916. For other discussions of this decision, see de Cecco, Money *and Empire*, ch. 7, and R. S. Sayers, *The Bank of England* (Cambridge, 1976), Vol. 1, pp. 60-5, 66-77; see also J. M. Keynes, *The Collected Writings of John Maynard Keynes* (hereafter *JMK*), (eds) D. E. Moggridge and E. Johnson (London, 1971), Vol. 16, pp. 7-15.

10 Public Records Office, London (P.R.O.), T172/643, Keynes's memorandum, 'The Probable Consequences of Abandoning the Gold Standard', 17 Jan. 1917.

11 P.R.O., T170/62, 'Exchange', E. C. Grenfell's memorandum, 20 Jul. 1915.

12 Russell Ally, 'War and Gold - the Bank of England, the London Gold Market and South African Gold, 1914-1919', *Journal of Southern African Studies*, 17, 2 (1991), pp 227-34; R. S . Sayers, *The Bank of England*, (Cambridge, 1976), Vol. 1, pp. 90-1 .

13 P.R.O., T170/62, Bradbury to Cunliffe, 24 Aug. 1915; T176/5, 'Gold Held in the United Kingdom, 1914-1922', Kitchin's memorandum, 22 Jan . 1923.

14 Kathleen Burk, 'The Diplomacy of Finance: British Financial Missions to the United States, 1914-1918', *Historical Journal*, 22, 2 (1979), pp . 355-6 .

reserves, she would have to raise loans in the United States market to finance four-fifths of her purchases in that market during the six months ending March 1917. Even assuming America could digest British issues at the rate of $200 million per month, 'we shall start the next half-year (April 1917 to September 1917) 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'.[15] With resources limited, and the ability of the New York market to finance British needs in some doubt, the report recommended reducing Britain's dependence upon the United States 'in every way compatible with the efficient conduct of the war'.[16]

Things got worse, rather than better, after this report, as an unsecured issue of British Treasury bills in New York got mired in a controversy which led to a wild run on sterling, nearly knocking it off its wartime perch and temporarily devastating Britain's credit in the United States.[17]Among other measures, this crisis forced the British government to cancel several orders for imports of munitions and other war requirements from the United States. Yet the financial crisis was only getting deeper. As Hardman Lever, head of the Treasury Mission sent to take over the financial agency business from Morgan and Company warned his government, 'assuming that we withdraw *all gold'* from the Bank of England, the Treasury reserve, and the joint-stock banks, which together totalled about $700 million, and the Russian and French Governments gave $300 million between them as promised, Britain could meet her United States obligations only for the next two months. 'For March and later ... we must depend on supply of new gold from Allies and any funds which may be raised from collateral and other loans'.[18] Britain's precarious hand-to-mouth financing of her war-related imports from the United States continued until the latter's entry into the war opened the door to official credits.

Apart from using them to finance her imports from the United States, Britain was determined to centralise and 'conserve' the empire's gold resources also in order to underpin the enormous credit structure needed to raise domestic resources for the war. As R.G. Hawtrey, a Treasury adviser, 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

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15 P.R.O., T170/95, Inter-departmental committee to consider dependence of the British Empire on the United States, Final Draft Report, unpublished, Oct. 1916, para. 12.

16 P.R.O., T170/95, summary of Final Draft Report.

17 See Burk, 'The Diplomacy of Finance', pp. 357-9.

18 P.R.O., T172/379, memorandum for the cabinet by Hardman Lever, 21 Dec. 1916; emphasis in the original.

> the amount of credit money we can create without losing all our gold.[19]

Further, although sterling was inconvertible for all practical purposes during the war, Britain was forced to use her gold resources in market intervention, since a stable currency was seen to be necessary to secure war-related supplies on credit from the rest of the world, and since the informal checks which Britain had imposed on sterling convertibility would not have survived prolonged exchange instability.[20]

The need to reduce exchange pressure on sterling and raise resources in New York also compelled the British government and the Bank of England to deploy formal and informal instruments to ensure that the United States did not lose gold to the rest of the world.[21] These checks impinged directly upon the financing of Indian trade. In August 1916 the Bank of England directed British-Indian joint-stock banks not to ship gold from the United States to India because such shipments 'must act detrimentally to the course of exchange between America and this Country ... (and) it is unpatriotic for British banks to take part in this business ....'[22] One year later an established British trading firm wishing to export gold from the United States to India was advised not to solicit the assistance of the Governor of the Bank of England at a time 'when the Imperial Government is in such dire need of the metal ...', for a transaction that would cause the 'export from one side of America' of 'Gold which he has been at such pains to get in to the other'.[23] Similar requests to non-British banks went largely unheeded, and protests grew from British banks fearing American and Japanese inroads into their exchange banking business in India. Probably in response, Walter Cunliffe, governor of the Bank of England, claiming that India's gold policy would 'have a very bad effect on financial arrangements with America which are all important', threatened to raise 'money rates' (i.e. interest rates) in London if gold imports into India were not banned. But since officials in Delhi were resolutely opposed to a ban, Whitehall decided upon a compromise arrangement which allowed imports of gold into India only against licence, and which required the government to procure the metal upon arrival. The

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19 P.R.O., T170/100, note, 6 May 1916.

20 Estimates differ, but between a tenth and an eighth of Britain's wartime debt of nearly $25 billion is said to have been accounted for by the cost of maintaining sterling's wartime parity with the dollar; see D. E. Moggridge, *British Monetary Policy 1924-1931* (Cambridge, 1972), p. 17; Sayers, *Bank of England,* Vol. 1, pp. 87-94 .

21 Sayers, Bank *of England,* Vol. 1, pp. 84-94, 99-107.

22 Bank of England (B.O.E.), C40/321, C40/322, Chief Cashier to Chief Manager, Mercantile Bank of India, 1 Aug. 1916; similar letters were addressed to the other banks, including non-British ones like the Yokohama Specie Bank and the International Banking Corporation.

23 B.O.E., C40/32, Chief Cashier to Ralli Brothers, 3 July 1917; also see his letters to Banque Belge pour l'Etranger, 11 Apr. 1917 and to the Secretary, Treasury, 24 Apr. 1917; Brien Cokayne to, the rather appropriately named, Sir Adam Block of the Ministry of Blockade, 29 May 1917.

price offered by the Indian government for the gold was so low, that the new regulations acted effectively as a ban on gold imports into India.[24]

Although the British Treasury advised the Secretary of State for India in June 1917 that the American authorities objected to gold flows to India, there is little evidence in the records of such opposition prior to the United States's entry into the war.[25] On the contrary, as the limits placed on council bill sales (discussed below) began to hit American importers, the United States Consul in Calcutta was advised by his government to enquire why gold or silver imports into India had been banned, and whether it was not possible to secure a relaxation of the ban to enable United States importers to remit funds.[26] The British Treasury utilised these and similar suggestions from the United States government to persuade the Indian government to sell rupees in the United States against gold deliveries in San Francisco. This arrangement suited the British Treasury, since gold would now be more easily available to it, should the need arise, for use in the United States[27]

British officials were, for their part, also determined to rouse the United States authorities out of their relative indifference towards gold flows to

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24 B.O.E., C40/32, Walter Cunliffe to Austen Chamberlain, 15 June 1917; Chamberlain to Cunliffe, 15 June 1917; Chief Cashier to Secretary, Treasury, 21 June 1917; John Bradbury to Cunliffe, 20 and 25 June 1917; C40/322, Chief Cashier to the Treasury, 18 June 1917. Austen Chamberlain was the Secretary of State for India, and Walter Cunliffe was Governor of the Bank of England at the time. NationalArchives of India, Government of India, Finance Department (N.A.I., G.O.I.F.D.), A & F proceedings no. Dec. 1917-951-A,Controller of Currency to Secretary, Finance Department, Government of India, 19 June 1917; Dec. 1917-954-A, Viceroy to Secretary of State, 28 June 1917; July 1918-526-A, 'Rupee Price of Imported Gold - Note on letters from Mr. Howard, no. 2271-F dated 12 Oct., no. 2301/2-F dated 16 Oct., and telegram from the Government of India, dated 8 Nov.1917', Sept. 1917-629-34-A; Aug. 1918-852-A, Edward Cook's note, 5 Oct. and William Meyer's note, 10 Oct. 1917; Aug. 1918-896-A; Feb. 1919-708-C, M. M. S. Gubbay to H. F. Howard, 29 Nov. 1917; Meyer's note, 5 Dec. 1917; and Babbington Smith Committee, *Memoranda and Evidence*, QQ. 2891-8, 1246-54, 71, and 3323.

25 N.A.I., G.O.I.F.D., A & F proceedings no. Oct. 1917-846-A, Secretary of State to Viceroy, 8 June 1917; proceedings no. Oct. 1917-884-A, Finance Department to Manager, Sumitomo Bank, 23 June 1917; proceedings no. July 1918-526-A, 'Rupee Price of Imported Gold - Note on letters from Mr. Howard, no. 2271-F dated 12 Oct., no, 2302-F dated 16 Oct., and telegram from the Government of India, dated 8 Nov. 1917', undated, unattributed document; proceedings, no. Aug. 1918-896-A, annex 2 to enclosure no. 2 to the Secretary of State's Financial Despatch no. 57 of 9 Nov. 1917, 'Further Memorandum by India Office on the Indian Currency Position dated 21st July'.

26 N.A.I., G.O.I.F.D., A & F proceedings no. Sept. 1917584-A, Cook to Howard, 29 June 1917. As of 2 Nov. 1917, the American authorities had applications from importers to ship to India gold worth $32 million and about 7 million ounces of silver; see Federal Reserve Bank of New York (F.R.B.N.Y.), C262.5, 'List of Applications for permission to ship bullion or coin to Calcutta and Bombay'; see also N.A.I., G.O.I.F.D., A & F proceedings no. Aug. 1918-784-A, Jukes to Howard, 18 Aug. 1917, 792-A, Cook to Howard, 23 Aug. 1917 and 798-A, Cook to Howard, 31 Aug. 1917; proceedings nos. July 1918-483528-A, Cook to Howard, 13 Aug. 1917.

27 India Office Library and Records (I.O.L.R.), L/F/5/36, United States Ambassador to Foreign Office, 31 May 1917; Treasury to India Office, 18 June 1917; India Office to Foreign Office, 19 June 1917; also see B.O.E., C40/322, Cokayne's marginal note on the India Office letter.

India. The British Consul General in New York was asked by the Foreign Office to convey the British Treasury's view that the Americans should limit their imports from India to articles of national necessity and thereby 'diminish ... the need for the export of gold from the United States to India ....' At the same time the Indian government was informed that, '... in accordance with the urgent requests of the Chancellor ..., and in order that Imperial interests of primary importance may be protected', enquirers were being informed that gold shipments to India '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.'[28] The suggestion about gold shipments from the United States was, as far as the latter's government was concerned, entirely gratuitous and unsolicited.

Official accounts of the financing of Indian trade during the war would have us believe that reduced gold flows were caused by restrictions imposed by 'belligerent countries'. But it is clear that this simplified account reflects the bureaucrat's habit of dissimulation better than it does the actual course of events, or the underlying financial processes at work during these years. Since the checks on gold flows to India had important effects on her trade and incomes during and after the war, it is useful to place them back in the context from which they have been abstracted. Once thus relocated, it becomes clear that controls on wartime gold flows to India derived from Britain's external liquidity crisis, and the former's subordinate position as her colony. In the end, of course, the Americans were only too keen to follow the British lead in the matter.[29]

Britain's external payments disequilibrium in the form of a dollar-gap or a gold shortage, together with her fear of deeper commercial and financial dependence upon the United States had two distinct, but associated, consequences for India. In common with the rest of the empire, she felt the pinch of Britain's efforts to source a larger share of imports from her. The manner of financing India's surpluses was also affected. Silver imports

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28 I.O.L.R., L/F/5/36, Foreign Office to Consul General in New York, 20 June 1917; Secretary of State to Viceroy, 19 June 1917; although the policy to block gold flows to India had been in effect since at least August 1916, it was only now that the Indian government was formally taken into confidence.

29 For contemporary recognition of this, see I.O.L.R., L/F/5/36, Ambassador to Foreign Office, 18 Sept. and 25 Sept. 1917; Foreign Office to HM Ambassador, 26 Oct. 1917; Secretary of State to Viceroy, 28 Sept. 1917 and 25 Oct. 1917; Viceroy to Secretary of State, 2 Oct. 1917 and Foreign Office to H.M. Ambassador, 26 Oct. 1917; H.M. Consul General in New York to Foreign Office, 9 and 18 Jan. 1918; Viceroy to Secretary of State, 28 Jan. 1918; India Office to Treasury, 25 Jan. 1918 and reply, 31 Jan. 1918; Reading to Foreign Office, 27 Feb. 1918 and reply, 3 March 1918; F.R.B.N.Y., C262.5, 'Telegram drafted by the United States Authorities and Submitted to Sir H. Lever' a copy of which Keynes handed over to Lionel Abrahams in Oct. 1917; National Archives and Records Administration of the United States government, Washington D.C. (N.A.R.A.), RG 56, box 85; Governor of the Federal Reserve Board to W. G. McAdoo, Treasury Secretary, 10 July 1917; also see N.A.R.A., M335, roll 20, Foreign Trade Adviser to Secretary of State, memorandum, 9 Oct. 1917.

declined considerably in the early years of the war as the metal had to be imported against scarce dollars, while gold imports into India also declined. As a result of these checks, imports of gold and silver yielded place, where India was concerned, to the accumulation of British government securities in London, particularly during 1915-17. This change in the manner of financing India's trade balances with the rest of the world created a fresh set of problems in the colony. These problems occupied the minds of officials in India, Britain, and to an extent, in the United States for the remainder of the war, and are discussed below. But first, it is necessary to outline India's trade and financial situation during the war.

III

India's annual average trade surplus was slightly lower during the war and in its immediate aftermath than in the five years immediately preceding it. India's trade surplus had averaged about Rs.784 million during 1909/10-1913/14, but this figure fell to about Rs.764 million for the period 1914/15-1918/19. No doubt the average concealed some variations, the 1914/15 surplus (Rs.437 million) having been the lowest since 1908/09. But set against a pre-war peak of Rs.893 million (1911/12), the highest annual wartime surplus of Rs.921 million (1916/17) does not bespeak a strong war-induced boom in Indian trade.[30] Lest it be supposed that these supluses reflected an import boom, it is worth pointing out that India's annual average exports were actually lower during the war years than in the five years preceding them. India's experience is in marked contrast to that of countries such as the United States and Japan, both of whom experienced a tremendous expansion of their exports during the war. The principal reason for this state of affairs was that problems of financing her trade led the colonial authorities to restrict India's exports to essential war items. Exports not related to the war effort suffered as a consequence.

That the manner in which Indian trade was financed changed can be attributed to liquidity problems at the centre. In the five years immediately preceding the war, about thirty-seven per cent of India's trade surplus had been liquidated by *private* imports of gold and about nine per cent by those of silver. In contrast, private imports of gold coin and bullion, despite being inflated by arrivals from Japan during 1917/18, were down to some ten per cent of the war-time surplus. Private silver imports also fell to about five per cent of India's trade surplus during these years.[31] The bulk of the surplus was

30 Committee on Indian Exchange and Currency (hereafter Babbington-Smith Committee) (B.P.P. 1920, XIV), *Memoranda and Evidence*, app. II to memorandum A by Lionel Abrahams, p. 8; *Report*, para, 8 and para. 12; summary rupee figures are in Royal Commission on Indian Currency and Finance (herafter Hilton-Young Commission) (B.P.P. 1926, XII), *Memoranda*, Vol. 2, McWatters's memorandum, app. II to app. 3, p. 25.

31 *Loc. cit.*

therefore financed through council bills (sterling purchases in London against the issue of rupees in India), and after the nature of the Indian currency system made it unavoidable, through silver imports from the United States and elsewhere on the government account. Thanks to these imports, the bulk of which took place after 1916, silver liquidated nearly a third of India's trade surplus during the war years. Very little gold was imported on the government account, so that the relative importance of the two metals in liquidating India's trade surplus was reversed, with silver replacing gold as the major means of satisfying India's demand for precious metals during the war.[32]

It was not until 1916/17, however, that the real problems of financing Indian trade emerged. Sales of council bills in that year totalled £32 Million, against private gold bullion imports of £4 million.[33] This one-sidedness led, as Table A-1 in the appendix shows, to the note issue expanding against securities in the Paper Currency Reserve. Through successive ordinances, the Rs.200 million ceiling on the investment component of the reserve was relaxed to Rs.1000 million.[34] Partly under pressure from the Bank of England, the Indian currency reserve's holdings of British treasury bills rose from £4 million to £55 million between March 1916 and March 1919, this increase representing about a tenth of the increase in the stock of these bills outstanding.[35] The Indian demand for their bills could not have come at a better time for the British Treasury. As an official in the Indian government's Finance Department recognised, one of the aims of increasing investment in bills was to 'free ...gold for the Bank of England and the London money market.'[36] Not only did India emerge as the largest single source of demand for Treasury bills which even London clearing banks were not keen to hold, the stability of these Indian holdings assisted the British Treasury in a climate wherein the Bank of England was extremely reluctant to meet the short-term financial requirements of the British government.[37]

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32 Reserve Bank of India, *Banking and Monetary Statistics* (Bombay, 1953), pp. 971, 981; for a good description of the council bills mechanism, see *JMK*, Vol. 1: *Indian Currency and Finance* (London, 1971).

33 Refer to footnote 30.

34 Babbington-Smith Committee, *Memoranda and Evidence*, app. D. to app. I, Howard's memorandum, p. 31.

35 For treasury bill holdings in the currency reserve, see Hilton-Young Commission, *Memoranda*, app. V to app. 3, McWatters' memorandum, Vol. 2, pp. 28-31; for evidence of the Bank of England's successful efforts to press the India Office to hold treasury bills, see B.O.E., G30/3, Cunliffe to Chamberlain, 17 Jan. 1017; Lionel Abrahams's reply, 18 Jan. 1917; Cunliffe's note on their telephonic conversation on 22 Feb. 1917; Chamberlain to Cunliffe, 24 Mar. 1917 and reply, 26 Mar. 1917.

36 N.A.I., G.O.I.F.A., A and F proceedings no. Feb. 1916-112-A, 'Statement of the Case' by J. B. Brunyate, 4 Jan. 1916.

37 School of Oriental and African Studies, Addis Papers, Pp. Ms 14/393, 'Banks' Monthly Returns', memorandum by Hawtrey, undated but May 1921.

IV

The Indian currency system operated with two levels of token currency: currency notes and silver rupees. The authorities were committed to converting notes presented by the public into the silver rupees they preferred to hold. This apparent idiosyncracy meant that expansion against securities could not go on indefinitely in India, and by December 1916 it had begun to create other problems. As silver rupee coins in the currency reserve continued to fall even through the lean summer months, the Indian government's ability to fulfil its commitment to exchange notes for these silver coins was felt to be under grave threat.[38] On the other hand, by now the Indian public had begun to show a rising preference for silver rupees, as lower commodity and treasure imports tended to block their normal channels of spending and saving. As liquid savings increased, the desire to move out of rupee notes and into silver coins grew stronger.

In general, the minds of officials at the Government of India's Finance Department boggled at the thought of a breakdown of convertibility. Its officials expected inconvertibility to cause an irreversible setback to the procurement of war supplies in India, a rise in the prices of her exports, panic withdrawal of deposits from banks and post offices, and a fall in the prices of government securities. Inconvertibility was also expected to lead to lower recruitment in the army, increased working class disaffection, and the spread of political agitation. The long-term effects on government credibility as regards the note issue and on post-war resource mobilisation were also feared, one official going so far as to warn that inconvertibility would deal a greater blow to British prestige in India than any military defeat, than even a German landing at Norfolk![39]

In the short-term, free silver (or gold) imports would have helped reduce pressure on official domestic metallic reserves. Officials did seek increased supplies of precious metals to tide them over their problem, and Britain arranged for limited quantities of sovereigns to be shipped from Australia. But in general, Britain was reluctant to release gold for India, or spare scarce dollar resources to finance silver imports. In addition, there was also the risk that any enhanced demand for silver from India would further push up the

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38 This was the operational crux of the 'convertibility problem' as discussed in this paper; all references to 'rupee convertibility' in this paper are to this domestic, rather than to any external, convertibility problem; for a good description of the Indian currency system, see *JMK*, vol. 1.

39 N.A.I., G.O.I.F.D., A & F proceedings no. Oct. 1918-1000-A, 'Memorandum by Mr. M.M.S. Gubbay, ..., Controller of Currency as to the Probable Effects of Incontrovertibility' enclosed with Viceroy to Secretary of State, 23 Jan. 1918; see also proceedings no. Oct. 1917-850-A, Controller of Currency's telegram, 14 June 1916: proceedings no. Sept. 1917-586-A, Viceroy to Secretary of State, 7 July 1917; the comparison with military defeat is from proceedings no. Sept. 1917-584-A, Cook to Howard, 2 July 1917; also see Babbington-Smith Committee, *Memoranda and Evidence*, app. II to memorandum B by Lionel Abrahams, pp. 84-8; O. 477; B.O.E., C40/322, Cunliffe to E.S. Montagu, 19 Sept. 1917.

metal's prices in the world markets, and complicate the management of the Indian currency system.[40] Therefore, much as they disliked a regime of controls, the Indian government was forced to link the sales of council bills to the availability of gold and silver.[41] Deploying so generally deflationary an instrument not in order to check price increases in the tradeable goods sector, but in order merely to reduce the public's demand for silver coins might seem at best an over-reaction. But so preoccupied were officials with immediate problems of an administrative nature that they were generally indifferent to the effects of their policy on non-target variables; and domestic income losses, arising from policy shocks triggered by the need to preserve interests they judged vital, were of no account.[42] In effect then, with Britain facing a severe external financial crisis, and with the Indian currency system lacking much fidiciary flexibility, the availability of silver (and gold) acted as a check on domestic incomes as well.

Measures such as restrictions on council bill sales only helped extend a vicious circle, not break it.[43] Even with her exports confined to war necessities, the demand for rupees in India was pressing enough to compel her government, eventually, to buy large quantities of silver in the open market.[44] This demand, together with stagnant levels of output from the mines, increased world silver prices.[45] Indian prices rose by more because of

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40 N.A.I., G.O.I.F.D., A & F proceedings no. Dec. 1917-947-A, Secretary of State to Viceroy, 15 June 1917; proceedings no. Oct. 1917-850-A, Controller of Currency to Finance Department, 14 Dec. 1916 and 14 June 1917; Sept. 1917-586-A, Viceroy to Secretary of State, 7 July 1917; also see proceedings no. Aug. 1918-896-A, enclosures to the Secretary of State's Financial Despatch No. 57 of 9 Nov. 1917, especially India Office to Treasury, 21 July 1917, annex 1, 'Memorandum on the Indian Currency Position as affecting War Office Payments and the Purchase of Commodities of Essential National Importance, sent by the Secretary of State to Chancellor of the Exchequer, 28th April'; annex 2, 'Further Memorandum by the India Office on the Indian Currency Position, dated 21 July'; Treasury to India Office, 30 July 1917; India Office to Treasury, 8 Aug. 1917; Treasury to India Office, 20 Sept. 1917.

41 Babbington-Smith Committee, *Memoranda and Evidence*, memorandum A by Lionel Abrahams, paras. 6-8; *Report*, para. 21; N.A.I., G.O.I.F.D., A & F proceedings no. Oct. 1919-686A, Mant's note, 28 Aug., and Howard's note, 29 Aug. 1919. This measure led to a virtual dual exchange-rate mechanism; see N.A.I., G.O.I.F.D., A & F proceedings no. Oct. 1917-751-A, Viceroy to Secretary of State, 13 March 1917.

42 N.A.I., G.O.I.F.D., A & F proceedings no. Aug. 1918-836-A, Cook to Howard, 18 Sept. 1917; also see the references; cited in note no. 39.

43 Other measures to forestall convertibility included limited sales of gold, mainly to finance wheat procurement in Punjab, checks on the movement of silver rupees, etc.; on these see N.A.I., G.O.I.F.D., A & F proceedings no. Oct. 1917-637-779-A, enclosure no. 1, joint letter of exchange bankers addressed to Secretary of State, 18 Dec. 1916; enclosure no. 2, reply, 27 Dec. 1916; enclosure no. 4, Lionel Abrahams to the Chartered Bank of India, Australia and China, 18 Jan. 1917; Babbington-Smith Committee, *Memoranda and Evidence*, Q. 179, QQ. 254-6, 659-65, 1113-7, and 1196-1210.

44 Babbington-Smith Committee, *Memoranda and Evidence*, memorandum A, paras. 6-8; QQ. 33-4, 71, 323-4 and 1056-9; Reserve Bank of India, *Banking*, p. 980.

45 Reserve Bank of India, *Banking*, p. 980; Babbington-Smith Committee, *Report*, paras. 15-8; N.A.I., G.O.I.F.D., A & F proceedings, no. Aug. 1918-896-A, annex 2 to enclosure no. 2 to the

controls over private imports, in turn strengthening the Indian householder's desire to hold his savings in the form of rupee coins.[46] Through a process of rupee revaluation beginning in August 1917 and through controls on world silver prices from April 1918, policy-makers in London, New York, and Delhi ensured that the rupee would remain a token coin. However, the demand for rupees did not ease, and gave rise to the single-most important financial problem in India during the war.

Clearly, as Indian officials recognised, a decisive intervention to prevent the collapse of the Indian currency system was not possible until the government's stocks of metal were substantially augmented, and in the background of Britain's external financial problems, India stood a better chance of securing silver than gold. But for silver imports to be part of the solution, rather than the problem, it was necessary to ensure that they did not fuel further increases in the world prices of the metal. Hence forestalling a currency collapse in India involved drawing on the resources of the American government, since the United States was the only country with sufficient reserves of silver to meet the colony's needs, and the ability to stabilise the price of the metal. The joint Anglo-American effort to stabilise the Indian currency system also underlined that convertibility was not purely a domestic issue for India, but that potentially, it had consequences which would have been damaging for the international monetary system at large.

Paradoxically in the light of later Western concern about its consequences, the Indian government did not find it easy in the early months to persuade Whitehall officials, preoccupied with the more immediate problem of minimising their dollar expenditure while procuring war materials from wherever possible, of the dangers of inconvertibility in India.[47] But as the Indian currency crisis deepened, appreciation grew of the important but unobtrusive role which the rupee's domestic convertibility played in the smooth operation of the gold standard. By keeping India's monetary demand for gold within bounds, it was seen to improve the liquidity of the international system; preserving it was judged to be crucial since on the eve of the war India's non-monetary demand for gold accounted for nearly a quarter of the world's output of the metal. A declaration of inconvertibility, it was feared, would greatly add to this demand, more so should Indian asset-holders decide to export their large stores of silver in order to replace them with gold.[48] Hence a default by the Indian government on its commitment to

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Secretary of State's Financial Despatch no. 57 of 9 Nov. 1917, 'Further Memorandum by India Office on the Indian Currency Position dated 21 July'.

46 For data on seasonal demand for silver coins during the war, see Hilton-Young Commission, *Memoranda*, vol. 2, app. 11, p. 76.

47 N.A.I., G.O.I.F.D., A & F proceedings no. Sept. 1917-584-A, Cook to Howard, 2 July 1917: see also the references cited in note no. 40 above.

48 I.O.L.R.., L/F/6/1084 f. 6186, India Office statement 'Indian Currency and Exchange, 2 Feb. 1920; L/F/7/612, 'Note by Mr. Lucas', 15 Jan. 1920; the *Times*, 3 Feb. 1920; F.R.B.N.Y., C262.5,

encash notes in silver was feared to have disastrous effects on the global liquidity position. As Lionel Abrahams, the Assistant Under-Secretary of State at the India Office put it, inconvertibility in India would be unfortunate not just for her but for 'civilized countries generally .... It would be a sin against civilization' to allow it to come about.[49]

V

As mentioned above, India's monetary authorities wrestling with her seemingly intractable currency problems soon recognised that their most practical solution lay in the availability of silver. The British government had been buying some silver in the United States since December 1916, mainly on the Indian account. After the United States's entry into the war enabled Britain to avail itself of official dollar credits, a small portion of these had been used to buy silver for India. Although quite small by the standards of later years, these purchases did not escape the attention of silver interests on either side of the Atlantic who recognised that the 'only buffer to protect our Western gold reserves against the Indian drain (was) a silver buffer'. While anticipating silver prices to rise, these interests were also aware that the West's concern to prevent a large appreciation of the rupee during a period of inelastic demand for India's exports would lead to efforts to stabilise silver prices at least as long as the war lasted.[50]

The large quantities of silver required to help preserve rupee coinage, and the need to regulate the effects of this demand on the metal's prices and the rupee's exchange rate forced the British authorities to go back on their attitudes of the past thirty years, and formally seek United States cooperation on Indian monetary matters. The United States Treasury had, for various reasons, come to hold large reserves of silver, and these were potentially a major influence on supply conditions in the market for the metal. Although a liability to the department and a source of uneasiness to many United States officials attempting to inaugurate a reformed financial system, these reserves could not be liquidated owing to opposition from United States's politically powerful silver producers. British officials were not slow to realise the new use to which these reserves could be put, and attempted to impress upon their United States counterparts the advantages of exporting them to India. Discussing ways in which economies could be effected in the use of gold, the Governor of the Bank of England told Benjamin Strong of the Federal Reserve Bank of New York that silver was as useful in India as gold,

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Strong to Jay, 16 Sept. 1919, p. 3; for early speculations in this regard, see N.A.I., G.O.I.F.D., A & F proceedings no. Dec. 1917-951-A, Cook to Howard, 19 June 1917.

49 Babbington-Smith Committee, *Memoranda and Evidence*, Abrahams's answer to Q. 78.

50 Morten Frowen in the *Financial News*, 19 Nov. 1917; Frowen was considered by the India Office to represent silver interests; see I.O.L.R., L/F/7/603, Montagu to Crewe, 13 May 1919 .

'while it is difficult to believe that a more favourable opportunity will recur for cutting the loss on your silver reserves'.[51]

The United States Treasury was attracted by the possibility of disposing of a portion of its silver holdings at a profit. However, in addition to opposing Treasury silver sales, American silver producers were, for historical reasons, deeply suspicious of dealings in the metal with Britain. Negotiations had therefore to be conducted with care, tact, and discretion. In practical terms, these considerations translated into a high enough price for the metal to satisfy the producers while minimising, to the extent possible, the likely increase in the prices of India's exports, and the assurance that the silver rupee would be a full-bodied coin, and not merely a token one.[52]

The final legislation that emerged out of these negotiations involving the British and American governments and the United States silver producers was the so-called Pittman Act. Its objectives were explicitly set forth in the title: among others, the Act was meant to 'conserve the gold supply of the United States; (and) to permit the settlement in silver of balances adverse to the United States'.[53] The Act empowered the United States Treasury to melt and ship to India up to two hundred million ounces of silver at one dollar per ounce, corresponding to a rupee parity of eighteen pence, at least a quarter of the total payment being made in gold. As part of the deal the British government undertook not to raise the rupee beyond eighteen pence as long as the war lasted, while the American government correspondingly undertook to keep silver stable at one dollar per ounce. The substantive deal reflected the relative bargaining positions of the parties involved. Britain agreed to pay one dollar per ounce when the ruling price before India's needs became known had been only sixty-eight cents.[54] The silver dollars melted down by the United States government were of no use to the latter and represented, even without further depreciation, a charge on its revenues. 'There did not seem to be any way to realise whatever value it did have, until along came this enormous demand for silver for settlements with India in 1917-1918'.[55]

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51 F.R.B.N.Y., Strong Papers, 1115.1/2, Cunliffe to Strong, 27 Oct. 1917.

52 For a discussion of the political problems concerning silver, see I.O.L.R., L/F/5/36, HM Consul General to Foreign Office, 13 July 1917; Reading to Foreign Office, 21 March 1918; Reading to Foreign Office, 26 April and 6 May 1918; Bayley to Foreign Office, 23 April 1918; also see 'Confidential Letter of a Well-Posted American in Washington', on p. 36 of the file; F.R.B.N.Y., C262.5, Edward Brush (American Smelting Corp.) to F. Kent, 7 Nov. and 22 Nov. 1917.

53 N.A.R.A., RG 82, Boxes 302-310 deal with the Act; for the relatively sparse material that exists at the Indian end, see N.A.I., G.O.I.F.D., A & F proceedings nos. July 1919-480542-A; see also note 27 above.

54 I.O.L.R., L/F/6/169, 'Silver Supply, Demand and Prices', memorandum by J. Kitchin, 25 Feb. 1931.

55 Hilton-Young Commission, *Minutes of Evidence*, George E. Roberts's reply to Q. 15099; Roberts was a New York banker.

With inconvertibility staring them in the face by the middle of 1918, and knowing that Britain would not allow gold to be exported to the colony, the Indian monetary authorities were grateful for any metallic assistance coming their way. But India had to sustain enormous losses on her silver reserves over a decade and a half after the metal's prices crashed in 1920 as Britain proved not as keen to stabilise silver prices against a fall as she had been to prevent a substantial rise durinq 1917-19, and the United States authorities found unilateral stabilisation both costly and ineffective.[56]

VI

Clearly, the changes in the manner of financing India's wartime trade were caused by British, and more generally Western, financial problems. India was unable to secure gold during the war because of the certainty that her exports, no matter how crucial to the war effort, could be financed without it. Thus her subordinate position as a colony meant, among other things, that when the countries at the centre were facinq a liquidity crisis, India would have to settle for a reduced share of superior assets and accept relatively inferior assets like sterling bills (which were now not quite 'good as gold') or silver. Put another way, the hierarchy of assets used to liquidate surpluses in the wartime international economy reflected the hierarchy of power in the international system. The United States refused to accept sterling credits secure in the knowledge that Britain would have no option but to export gold or incur dollar debts to finance her imports from that country. Britain also floated yen-denominated bonds to finance her imports from Japan during the war. But India had to rest content with sterling securities which depreciated after sterling went off the gold standard in March 1919, and silver which crashed no sooner Britain and the United States ceased to find it in their mutual interest to stabilise its price. As an official at the India Office explained to the post-war Babbington-Smith Committee, 'by the mere process' of placing 'gold in the west and silver in the east', a 'great advantage' would be secured for the whole world.[57] As the United States Treasury Secretary who helped finalise the wartime Anglo-American silver deal explained the reasoning behind it to Senator Pittman, the 'orient' was 'willing to accept silver in place of gold for the commodities furnished by them', and it was in the United States 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.

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56 P.R.O., T160/8, f. 260/3, 'Pittman Silver', memorandum by Bowley, undated, but Feb. 1933.

57 Babbington-Smith Committee, *Memoranda and Evidence,* F. Lucas's reply to Q. 4459; Lucas and other officials assumed that silver was the 'natural metal' of the east, and gold of the west.

He also pointed out that silver meant a definite settlement of Indian surpluses, while any other medium 'always meant a deferred demand for gold'.[58]

Furthermore, the crisis which the reduced availability of precious metals created for her currency system, itself designed with the intent of reducing India's gold imports, led to export controls, because of which Indian exports were actually lower, on average, during the war years than they were during the corresponding pre-war period. The threat to the Western liquidity position of the Indian householders' demand for precious metals persisted even after the war ended. Meanwhile Britain's economic dilemmas only grew more complicated, since once the post-war boom was arrested, her policy-makers came face-to-face with the persistent problem of mass unemployment. Sterling had also come off the gold standard at the end of March 1919; policy to combat unemployment had to take into account the objective of returning sterling to the gold standard at the pre-war parity, and thereafter of preserving it there in an uncertain economic climate. This meant, in practical terms, that Britain could not undertake independent efforts to boost domestic employment without risking an increase in the rate of inflation at home, a deterioration in the balance of payments, and a weaker sterling. Volatile capital markets further exacerbated this constraint. As if these problems were not daunting in themselves, Britain had to attempt their resolution against the backdrop of a weakened overseas investment position, disruption of world trade and payments and the loss of traditional export markets, and the compelling urgency of restructuring her industrial sector. Hence, she came to depend on the United States to create an expansionary global economic environment through low interest rates and liberal capital exports.

India had an important role in Britain's global economic agenda. As Keynes had argued in 1913, and officials came to recognise as the decade wore on, Indian gold imports rose in a world boom and acted to check it. Conversely, they fell or turned negative in a slump.[59] Since Britain sought expansionary world conditions during the 1920s in order to tackle the challenges facing her economy, it became vital for her to regulate the cycles of Indian gold absorption and dis-absorption. In other words, once set, the wartime pattern of attempting to curb the Indian demand for gold directly as well as through deflationary policies continued in different degrees to characterise British financial priorities in India throughout the inter-war period. These priorities, in turn, underlay Britain's refusal to grant even a semblance of 'monetary autonomy' to the colony almost until 1947.[60] The

58 I.O.L.R., L/F/5/36, W.G. McAdoo to Senator Pittman, undated letter, enclosed in Reading to Foreign Office, July 1918.

59 *JMK*, vol. 1, pp. 70-1; Babbington-Smith Committee, *Memoranda and Evidence*, memorandum C and 'Supplement to Memorandum C', both by Lucas; QQ. 340-47.

60 Balachandran, 'Towards a "*Hindoo* Marriage"'.

Indian economy was forced to undergo a severe dose of deflation in 1920-21, at the end of which she emerged as a net exporter of gold.[61] Deflation dominated the policy agenda through the 1920s, and when India turned an exporter of gold in the depression of the 1930s, policy focused on encouraging the tendency.[62] Efforts to check Indian gold imports succeeded during some years and failed during others. But during the inter-war years taken as a whole, India's annual average gold imports were a fraction of what they had been during the corresponding pre-war period. Thanks to Britain's manipulation of the colony's exchange arrangements, the inter-war period was also a deflationary one for its economy, and what little economic expansion the rest of the world saw during these years 'virtually by-passed India'.[63]

Appendix:

Table 1 : Composition of the Indian Paper Currency Reserve (PCR)

Last day of		*Size of PCR (Rs. million)*	*Proportion of PCR of*		
			Gold	*Silver*	*Securities*
March	1914	661	47.8	31. 0	21. 2
Sept.	1914	605	19.2	57.7	23.2
March	1915	616	24.9	52.5	22.7
Sept.	1915	638	19.0	59.2	22.9
March	1916	677	35.8	34.8	29.4
Sept.	1916	716	32.0	35.8	32.2
March	1917	864	21. 6	22.2	56.2
Sept.	1917	1084	16.0	27.3	56.7
March	1918	998	27.6	10.8	61. 6
Sept.	1918	1344	15.3	20.7	64.0
March	1919	1575	11. 4	24.4	64.2
Sept.	1919	1719	12.4	29.7	57.9

[Size of the paper currency reserve = gross coin and note circulation; percentages may not add up to 100 because of rounding off.]

Source: Hilton-Young Commission, *Memoranda*, app. V to app. 3, McWatters's memorandum, vol. 2, pp. 28-31.

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61 Balachandran, 'Britain's Liquidity Crisis and India, 1919-1920 '

62 Balachandran, 'The Sterling Crisis and the Managed Float Regime in India, 1921-24', *Indian Ec. & Soc. Hist. Rev.*, XXVII, 1, 1990; for the depression experience, see Balachandran, 'Gold and Empire'.

63 D.H. Aldcroft, *From Versailles to Wall Street, 1919-1929* (London, 1977), p. 216.