CHAPTER TWO: CURRENCY MANIPULATION:
AIMS, AGENCIES AND
CONSTRAINTS.

(i) Prologue
(ii) Trade Remittance and Currency Manipulation
(iii) Limitations of Manipulations
(iv) Government of India's Revenue Requirements
(v) The Way Out: Sterling Loan
(vi) Gold Exports
(vii) The Imperial Perspective
This chapter plants our attention smack in the middle of a quicksand of currency manipulation. The Government of India had to very often struggle to keep its head clear an effort that drew it deeper into monetary chaos. The story begins with the organic relationship between Remittance and Trade and takes off from Bagchi's groundwork to describe the increasingly more severe instruments that were used, from contraction to the massive and deliberately encouraged export of gold. Almost all of this was a mystery to contemporary analysts who in fact saw only the consequences of manipulation and only guessed at the extent of disturbed monetary conditions.

The actual process of currency manipulation was a detailed strategy to keep the exchange rate at an equilibrium that would make the offtake of surplus more efficient. The operation involved both a contraction and an expansion of currency, and despite its ultimate purpose, rupee manipulation was a highly precise exercise. The India Office, the Finance Department, and the Imperial Bank had to balance the priorities of London's financial
interests with those of the trade, commerce and industry of India, and they did so with a skill that was remarkable. But whatever the purpose, the Finance Department caught between the Bank, and the India Office were on occasion sternly reminded that their allegiance lay to the Secretary of State for India, as a member of His Majesty's Cabinet. And indeed in terms of monetary policy there were substantial reasons why the Finance Department had often to be reminded of the constitutional position and its ultimate responsibility to His Majesty's Minister for India - reasons that were generated by under-currents in Imperial policy between the two Wars.
With the close of the First World War and the financially chaotic years that followed, the Government of India had begun to adopt a more cautious policy towards Indian currency and finance. Since these years were also marked by a considerable uncertainty in exchange rates and inflation, private business regarded the increasing public debt and the large expenditure on current account with growing alarm. The Indian Retrenchment Committee in 1922 and the government's own efforts encouraged the government to cling more closely to the principles of 'sound' finance. There was however a deeper rationale for this increasingly conservative attitude.

Trade, Remittance and Currency Manipulation.

The metropolitan economy of Britain could no longer retain its monopoly of the Indian market, and it became more important to facilitate the transfer of surplus to maintain the stability of the pound rather than to preserve the myth of 'Free Trade'. Free trade was clearly (after 1914) no longer possible, what with the Japanese and the Americans savagely competing for as much tariff patronage as they could possibly wrangle from the Government of India. Though tariff autonomy was conceded, fiscal and monetary autonomy was not; India's importance to the

1. A.K. Bagchi, 'Private Investment in India' p46.
continuing viability of British economy, and the overall interest of the empire was no longer as a market for the English industrial goods, but as a source of surplus in support of British banking, monetary and currency interests.

Before the War, India was the most important market for British produce.¹ The concern of Lancashire with any proposal to introduce the principle of protection in the Indian budget reflected its anxiety to preserve the enormously profitable cotton piece-goods trade. The U.K. was the most important source of supply of industrial goods for India and also supplied between 61 per cent and 66.7 per cent of the annual imports of private merchandise of India during the years 1900 to 1924.²

---

1. The dominant policy pursued by the Government of India was one of Free Trade. Low revenue tariffs on cotton piece-goods were introduced in 1894. There were also duties on petroleum and salt. But in the case of both cotton piece-goods and of salt there were offsetting excise duties on Indian produce. A countervailing duty on bounty fed sugar was introduced in 1899 and the rate was increased in 1902-1903 to check the sale of beet-sugar from Europe. One can say that before the First World War there was no import duty which intentionally or unintentionally protected an Indian industry to any significant extent.


2. H. Venkatasubbiah, Foreign Trade of India, 1900-40; See also B.N. Ganguli, 'Reconstruction of India's Foreign Trade', pp 82-83.
This proportion would be larger if we add invisible trade, for the U.K. controlled practically all ocean shipping and a slightly smaller fraction of coastal shipping. Further, the important foreign exchange banks were all British, and the insurance services were also provided predominantly by British firms. The degree of India's dependence on the U.K. for imports would be even greater if we took into account imports of government stores, for these were almost wholly of British origin.¹

1. "On the other hand Britain was the largest purchaser of exports from India, but as against more than 60 per cent of the visible imports of private merchandise coming into India from the U.K. only 23.4 per cent and 30.1 per cent of Indian exports were taken by the U.K. over 1901-14. Even if we take the British empire as a whole, the proportion of Indian exports going to it did not rise to 50 per cent or more in any year except 1901 and fell to 37.7 per cent in 1914. This pattern of trade suited British needs quite well, for Britain had a large market into which her goods entered duty-free at a time when other markets were closing against her. On the other hand, a large portion of Indian exports earned foreign exchange (primarily raw materials, manufactured jute) going to countries within continental Europe and with the hard currency areas of America, with which the U.K. had normally a large deficit. These hard currency earnings accumulated as sterling in the hands of the S of S under the discretion of exporters who could then sell sterling to the government for rupees in return. Hard currency of State by the sale of councils, played an important part in fulfilling HMG's financial obligations. Before the war, however, it was only one of the several elements that nourished the imperial link with the Raj."
During the war, the main change on the import side (India's) was a marked loss in the U.K.'s share of the market. The contraction of trade, the unavailabilities of tonnage and the immense war effort temporarily cut India off from the European world. The Empire continued to record the gradual loss of the Indian market though the U.K.'s exports to India fell much faster than empire exports. The non-empire countries, however, expanded their trade with India, the U.S.A. and Japan contributing substantially to this overall increase.

On the export side, the flow of commodities was diverted towards the empire, the United Kingdom and Egypt being the largest buyers. There was a decrease in the percentage of goods demanded by non-empire countries though the U.S. and Japan actually increased their purchases.

With the advent of the post-war period, the U.K. became increasingly unable to retain its hold on the Indian market. The share of the U.K. in our import trade picked up after the war but steadily declined thereafter to the benefit of Japan and America. Exports that had been absorbed by the empire during the war fluctuated and then diversified to other markets, Japan Germany and, to some extent, America. There were circumstances which broke this completely uniform pattern, for instance, re-armament in 1938 and 1939 forced the U.K. to buy a
greater share of our exports, and Japan, being a belligerent axis power, was unwilling to continue its large share of India's export trade.¹

Within limits dictated by the circumstances then, trade with the U.K. had lost its viability, and India, though structurally colonial, had grown out of its position of industrial dependence on England. This impression is very strongly confirmed by the Victorian economy of Britain that had collapsed and crashed into ruin between the two World Wars. The traditional economy of Britain not only ceased to grow, but contracted. Statistics of production which had advanced almost

¹ Or for instance imperial preference articulated as the Ottawa Pact; see B.N. Adarkar, 'The Ottawa Pact' in Radha Kamal Mukerjee, ed., Economic Problems of Modern India, Vol. I, pp376-95; see also Chart in Appendix.
without a break for 150 years, to be sure not always
at the same or even at satisfactory rates, now
retreated. 1

1. Between 1912 and 1938, the quantity of cloth made
in Britain fell from 8,000 million to barely
3,000 million yards. Not since 1851 had Lancashire
exported so little. Between 1854 and 1913 the export
of British coal had grown from 65 to 287 million
tons. By 1938, it was down to 227 million tons.
In 1913, 12 million tons of British shipping had
sailed the seas; in 1938, there was rather less than
11 million tons.

In human terms, the ruin of the traditional
industries of Britain meant a certain amount of
unemployment. The labour force in cotton fell
by more than half between 1912 and 1938 (621,000
to 288,000) and its unemployment rate was, by no
means, the worst. In 1934, after the recovery
from the depression, 37 per cent of the labour
force in Glamorgan were unemployed and 36 per cent
in Monmouth. The situation was just as bad in
other places. The result was a growing movement
united by the consciousness of class separation and
exploitation capable of showing its force in such
acts of solidarity as the General Strike of 1926.

See p. Deane and W.A. Cole, 'British Economic
Growth, 1688-1959: Trends and Structure.' pp. 151-155
What is so significant is that despite the industrial devastation, one part of the Victorian economy resisted collapse. The city of London, called by D.S. Landes,¹ 'the nerve centre of international finance and the source of the world's capital', remained perhaps the only reasonably healthy part of the imperial machine during the two World Wars; though even this was to suffer after the depression. Britain was no longer the greatest international lender; indeed she was at the time, on balance, in debt to the U.S.A. Even so, by the middle of the 1920's British overseas investments earned more than ever before and so, even more strikingly, did her other sources of invisible income, financial and insurance services and so on. No doubt, this picture was no longer to remain as pretty. Between 1929 and 1932 her foreign dividends fell from £250 million to £150 million and her other invisible earnings from £233 to £86 million.²

1. D.S. Landes, op cit, p 295.
In spite of this, the imperial interest sought to extend and maintain its financial connections with its colonies even at the cost of Free Trade and Laissez Faire Imperialism.  

1. "In 1926, when the rupee was fixed at 1s6d, Indian manufacturers opposed it and prepared a lower rate in the interests of their exports. From the summer of 1930 till July 1931, differences over their policy increased between some Indian officials and officials in London. Indeed, Sir George Schuster, Finance Member in the Viceroy's Council, went as far as to suggest that the Indian manufacturers' demand for the devaluation of the rupee to 16p be permitted. The Secretary of State insisted that all other considerations must be subordinated to the prime objectives of maintaining the established currency standard. It was quite clear that by devaluing the rupee the Government of India might fail to meet the sterling liabilities of the Indian government debt and the pensions and provident funds of past and present European officials. A larger consideration was the priority attached to the maintenance of stability in the imperial system."

India was vital as a source of surplus for maintaining the British controlled gold standard and the political apparatus of the Empire.¹ Both of these would have been disturbed by any radical monetary reform.² Hence the interests of individual industries in England or of British industrialists in India were subordinate to the overriding imperial priority of the Empire.

1. One only has to go so far as the President's speeches, BMOA, 1936-37, to discover how serious the problem was. V.N. Chandavarkar's speech for 1936, BMOA, Annual Report Volume, Section 1, pp ii-vii.
Annual Report of the BMOA, 1935; H.P. Mody, Chairman's speech; see also evidence before ITB 1934, 'Special Tariff Board on Cotton Textiles.'


George Schuster remarked in this telegram:
"...our feeling is first that on economic grounds, it would be to India's advantage to stabilise at a gold level certainly not higher than 1s4d, preferably lower, say 1s3d. Secondly, that it would be a fatal error not to take this providential opportunity to escape from a position which has been the main underlying cause of the most bitter anti-British policy of the past few years. If this clamour of controversy is allowed to remain the maintenance of British financial responsibility or even effective financial safeguards will be made infinitely more difficult in the next few years."

See also Telegram XX from S of S, 20th Sept. 1931, File No. 1(10)F/1931.
II

The actual mechanism of transfer of surplus from India to the Secretary of State was a complicated and involved process of currency manipulation. The fiscal and monetary controls used to manipulate Indian currency to ensure remittance, were indulgently used, and with several years of depression, no effort was spared to satisfy the Secretary of State's treasury requirements.¹

The result was an over-valued rupee, supported by a deflationary policy that interfered with the trade and disturbed the normal working of the currency system. Not only did a 'tight money' policy raise rates of interest and militate against commerce and industry, it also opened the Indian market to huge imports from devalued currency areas like Japan and America. Once

¹. Much of this manipulation was done secretly, and transactions between currency reserves and the Government's own cash balance account, the proportion of outstanding T.B.'s and Government's short term debt were handled in such a way as to give the least impression of manipulation as was reasonably possible.

Memo (confidential) to Finance Member from J.B. Taylor 18 Sep. 1929, File No. 6(2)F/1929.
off gold standard, the Japanese Yen devalued so fast that trade treaties and tariff negotiations were out of date only months after agreements had been signed. The over-valued rupee and systematic remittances depressed exports and with shrinking trade balances the Government of India was forced to export gold in the teeth of commercial opinion, which saw this as the most damnable act of imperial rule.

Despite the storm of protest, weekly remittances to the Secretary of State, and efforts to control and maintain the 18p rupee were never given up.\textsuperscript{1} Currency manipulation, treasury bills, the rupee loan, ways and means of advances, contractions, the bank rate, India Bill, and the sterling loan, were measures to artificially raise the value of the rupee and satisfy Home Treasury's requirements. As each fiscal device to ensure remittance grew counter-productive, more and more draconian remedies were applied till the currency

\begin{quote}
1. A typical example of protest illustrates just how indignant such petitions could get in accusing government of manipulating the ratio.

"Government would be more honest if instead of attempting futile arguments and vague theories for explaining an indefensible position, they would have the courage to admit that deflation is a proper and legitimate lever to push up exchange. A careful study of the financial situation during the last two and half years brings out glaringly and unmistakably the fact that the Government are interested only in one thing, the maintenance of exchange at 18d, and that to bring this about, they are willing to view with perfect equanimity the terrible mess into which the money market has been brought."

\end{quote}

Indian Chamber of Commerce, Calcutta to Secretary, GOI, Fin. Dept., 21 May 1928, File No. 5(viii)F/1928.
situation grew unbearably complicated. The problem went unsolved and unremedied till the Second World War, when the conditions rapidly changed, leaving the inter-war period as a unique area of study.

III

Remittance and trade, though apparently unrelated, were merely two aspects of the same problem, i.e., currency management. The circulation of the rupee determined the amount of goods and services that were brought to the market and exchanged, which, in turn, gave the rupee an index of value. Similarly, the export of commodities to international markets determined the convertibility of the rupee into sterling, which was an approximate of the rupee's external purchasing power. This purchasing power measured in terms of sterling, and indirectly in other internationally accepted currencies, generated the wherewithal for imports, remittances, and the sterling expenditure of the Government of India. Hence if
the balance of trade in India’s favour was positive, an equal amount of sterling would be released on the exchange markets of Bombay and Calcutta. Exporters anxious to sell sterling at as low a rate as possible, and importers and the Government attempting to buy at as high a rate, determined the market price of sterling. Simple demand and supply laws fixed the rupee price of sterling. Of course, currency manipulation

1. For details on the purchase of sterling by the GOI through the IBI by the weekly or bi-monthly call for tenders, see GOI rules for sterling purchase and for the notification of 'intermediates'. 'Intermediates' were any purchases of sterling in the market made by the Imperial Bank, on behalf of GOI between two days of an official tender. 'Intermediates' was a term also used in connection with Treasury Bills, India Bills and any other short-dated government securities.


2. Ultimately, the volume of sterling released into the economy was dependent upon the export trade. Sterling loans, gold exports, and contractions were remedies to artificially swell the flow of sterling and were at best measures dictated almost always by poor trade. Indian officials in 1929, when the consequences of the stock market crash were beginning to be felt, were anxious to remind the India Office that there were limits to manipulation.

"I think we make it clear to the S of S that lowering of our rate will not in any way increase our total remittances which depend entirely upon the volume of trade."

GC to Fin. Dept., 21 Jun 1929, File No. 5(2)F/1929.
inevitably tipped the scales in favour of 1s6d rupee, but apart from this, the exchange value of the rupee was determined by the amount of sterling released into the economy, by positive trade balances.

The relationship between trade and remittance was tenuous and complicated. India's export trade consisted very largely of raw agricultural commodities, that had not been processed or manufactured. The most important items on the export schedule were raw cotton, raw jute, semi-processed jute, rubber, tea, grain and to some extent, tobacco.¹ These were primary products that were subject to seasonal harvests, and seasonal movements to the urban trade centres of Bombay and Calcutta. Though harvest seasons differed widely from region to region, and from crop to crop, the actual transportation and export of commercial crops was undertaken during a 'busy season' that extended from October/November to February/March. It was during the busy season that the annual earnings from the export trade found its way to exchange markets where sterling was bought and sold.

The Government's demand for sterling was an important financial function to those in charge of remittance. As a result, a weekly report was forwarded to the Finance Member by the Controller of Currency, advising the Governments on how much sterling to purchase and at what rate tenders were being offered at both Bombay and Calcutta.¹ The intimate connection between trade and remittance was borne out by such reports. The Controller of currency would estimate how much remittance might be possible in a particular

¹ All such reports were substantiated by daily 'Demi-official' letters and 'clear the line' telegrams which brought the India Office, the Fin. Dept., and the office of the Controller and Deputy Controller of Currency into close operational contact. Between these three offices a working policy towards currency and exchange was evolved by keeping a continuous check on the market and its influence on the stock of money, rates of interest, and the level of the exchange rate. The entire operation was enormously complicated and delicately balanced. Considering the magnitude of the subject, this was not surprising. Currency and remittance operations are compiled each year, and are now a part of the proceedings of the Fin. Dept. held in NAI.

See File 5(1)F/1929. That deals with the principles upon which remittances between India and Home Treasury were governed.
week of the busy season by estimating not only the quantity of export crops changing hands at clearing houses, but also by taking into account harvest conditions, rains, the price offered by foreign buyers, speculation and hoarding of crops and so on.¹ What is interesting is that most of such reports reveal the very direct and tangible connection between the export trade and the condition of the rupee sterling exchange. In May 1926, in the middle of the slack season, the Controller of Currency estimating remittances, wrote to the Finance Member, saying,²

¹ "Foreign buyers show no anxiety to purchase and will probably not come into the market with a large order till the weight of increasing stocks in Calcutta has brought down prices further.

A large demand for export finance on account of Jute is not likely to arise before the last week of September at the earliest.

In these circumstances, I see little hope of our obtaining much sterling by purchases in the market until the last week of September, and possibly later. If we come into the market now, either by attempting to purchase through the Imperial Bank or by an offer of Councils we should obtain little sterling, unless we are prepared to buy at two or three points below 1s6d."


² Endorsement to the letter from H. Denning, C.C. dated 20 May 1926, File No. 72-F-1926 N.A.I.
"If favourable rains are unduly delayed, it is possible that speculation in Bombay may force us to sell sterling and if we came into the Market either by an offer of Councils or by an attempt to purchase sterling, we should only weaken exchange without obtaining any appreciable amount of remittance. On the other hand, if we get favourable rains the market will probably strengthen, and if rains continue to be favourable it will probably never look back before the busy season and we shall be able to purchase sterling at increased rates in the same way as we did last year."

1. In May 1926, exchange had weakened because the market anticipated a 1s4d rupee that had been considered by the Currency Commission, whose report was awaited by exporters, thus starving the exchange markets of any business. It was at this juncture.

"On Thursday in Bombay, for instance, the sentimental influence of the delay in the appearance of the rains brought out a little speculation which forced the rate down to 7/8 and yesterday Calcutta followed Bombay." (1s5.7/8d).

H. Denning to Fin. Dept., 26 Jun File No. 72-F/1926.
Making estimates of how much sterling would be available at a particular time, was a tricky and uncertain business. The Controller of Currency and the Deputy Controller of Currency were required to estimate when Government should enter the market for sterling. If these estimates were wrong by as little as a week, the Government's demand for sterling could plummet exchange with the embarrassing consequence of Government's having to release sterling to steady the Rupee.¹ The Controller of Currency was quite aware that it was 'essential that the factors bearing upon the 1s6d ratio should be carefully watched all the time, and I am arranging for an automatic review with such means at our disposal.'²

There was little doubt that this anxious watch over the exchange markets was carefully kept, and there is no reason to dismiss the Controller of Currency's indices, on which he based the calculation of his estimates. If a foreign buyer showed no anxiety to


purchase till large stocks of jute in Calcutta brought down its price, the Controller would warn the Government not to enter the market. If the price of cotton, and the possibility of large exports were favourable, the Controller would encourage the Government to buy sterling in as large quantities as available, without the fear of depressing the rate.¹

Clearly, the link between exports and remittances was strong and well established, as British officials themselves recognised. However, currency manipulation added an important dimension to the problem. Not only was there an organic relationship between remittance and trade, but because of currency manipulation to enhance exchange, the relationship was, as a result, deliberate and contrived.

¹ D.O. Letter from H. Denning, Controller of Currency, dated 28 Aug. 1926, File No. 5(1)F.

Limitations of Manipulation

The purchase of sterling, which had replaced the sale of Council Bills in April 1927 was\(^1\) conducted by inviting tenders that quoted the rate and amount of sterling placed on the market for purchases.\(^2\)

From week to week in the two exchange markets in India, a multiple array of economic variables could raise, lower, or maintain the rate at which sterling was quoted. The movement of goods, the Bank rate, import of Bullion, Sterling Loan, and even the buying

\(^1\) The reason for abandoning the system of Council Bills as a method of regulating exchange was because it was difficult to assess as to how many Council Bills would be tendered in a given space of time. The purchase of sterling by tender transferred the initiative to the Imperial Bank of India, and could be varied in consonance with the demand of the Secretary of State and the Fin. Dept. The market could in fact be gauged from day to day, or from hour to hour allowing the Imperial Bank greater control over the rate at which it was instructed to buy.

See note by C.C., A.C. McWatters, 2 Dec. 1922
File No. Acc and Fin., May 1923, No.60-126, Part A.
This was a recommendation to replace the system, finally done away with in April 1927, See also File No. 5(1)F/1929 p 5.

\(^2\) From Denning to the Fin. Dept.

"...we may agree that broadly speaking our policy should be to accept tenders if these accorded closely with ruling market conditions. But our trouble recently has been that the market has been trying to anticipate the usual seasonal drop in exchange, even before the busy season comes to a close. If we had followed the market literally, we should have run the risk of depressing exchange by giving an erroneous impression that our sterling position was weak."

of forward exchange made it difficult for the Government to determine at what rate sterling would be quoted a week, a month or three months in advance of that date. Even though the Controller of Currency in Bombay and the Deputy Controller in Calcutta regularly analysed the market, there always lurked a persistent uneasiness in the reports of the Controller. It was just possible that the market might 'bounce the Government' and refuse to sell sterling at any price except one calculated to embarrass the Secretary of State financially.

To guarantee remittances of the Government of India, monetary policy was increasingly used to manipulate and match the market rate of sterling with its legislated rate. When C.H. Kisch wrote to the Controller of Currency of the Government for information on the attitude of the Government towards tenders offered

1. "The tender system suffers seriously from lack of the necessary elasticity. The Government have to fix a week in advance the amount which will be offered for tender, and between the day on which this amount is fixed and the day on which tenders are received, the conditions of the exchange market may have changed completely."

Memorandum on 'Method of Remittance to London'
As a result the tender system was abolished and the purchase of sterling instituted in its place.

in the market, H. Denning replied:

"It must always be remembered that the leading feature of the situation here is that Governments are far-away the largest remitters in the market, and that the Government operation bulk so largely that we are for many months in the year in a position of controlling the rate of exchange." 1

The Government, by postponing the demand for sterling and by depressing the market, could raise or lower exchange, only when a favourable purchase

1. Government demand for sterling was of such a magnitude that

"If...Government refuse to buy at the rate prevailing at the previous auction and reject tenders, the rate goes up till either the rate at which Government will buy is reached, or the rate is raised to such a figure that the supply and demand are equated naturally."

of sterling was available. Retarding or accelerating demand was, however, workable within limits.\(^1\) If for instance, the normal market equilibrium was upset by a decline in world prices, this invariably called for 'official circumspection' in regard to government control over the money market, which in plain English meant that more effective fiscal controls were required to regulate exchange,\(^2\) Safeguarding the

---

1. As the Controller himself admitted, that Government could postpone the demand for sterling, but unless conditions of trade justified a 'healthy exchange' the rate would tend to fall.

"...if I had not accepted 1s6d there might have been a little strengthening of exchange but as far as I could judge from my enquiries there is not sufficient export business in the market at present to keep exchange up, and any sentimental effect that might have been produced by rejection of the tenders would have been temporary."


2. Excess of exports over imports had shrunk so low that in 1930-31 only £690,000 sterling was released into economy. Severe shortages of sterling, as were common during the depression played havoc with exchange, and seriously disturbed the machinery of remittance. It was when export surplus could no longer support the transfer of sterling to the S.S. that manipulations and monetary controls became necessary and, in fact, essential to preserve the Government of India's credit standing on the London money market.
ratio, as Indian officials recognised, almost always involved a great deal of effort. From 1926 onwards with the legislation of the 1s6d rupee, this effort was used consistently to disallow any inflationary movement to get established.¹ A radical deflationary policy which became the most important financial consideration of the 14 years between 1926 and 1940, was employed to ensure a steady stream of remittances despite world depression and falling trade balances.

To reconsider the problem; it has already been established that the strength of the Indian rupee in terms of sterling could only be maintained by the annual surplus of exports over imports, that would release hard currency to the credit of India. If the demand for sterling in exchange for the rupee went beyond the capacity of the positive balance of trade

to satisfy, then the value of the rupee would drop till equilibrium was reached. ¹ After 1926 and the Hilton-Young Commission report, the Government was forced to guarantee the 1s6d rupee, not only because of government and private remittances, but because the entire sterling debt of India would have been that much more difficult to pay, what with mounting service charges on larger and larger amounts of principal. As a result, the Controller of Currency and the Secretary of State were more than anxious not to be embarrassed by any fall in the value of the rupee; the 1s6d rupee had to be maintained. Those in touch with currency in India were required to remit weekly, an average of £500,000 to £1,000,000 to the Secretary of State on home account, or what had come to be known as 'Home Charges'.

¹. The ultimate supply of sterling in the economy was determined by the volume of 'export bills' which was a direct indication of commodity movement. In 1929, the exchange position in Calcutta was weak and money dull. This situation

"...reacted on Bombay, where cotton exports are slow in moving and business is dull and the resulting weakness there was, emphasised by revival of bazar rumours that the ratio will be changed to 1s4d."

This connection between the commodity trade and exchange was undeniable.

D.O. from H. Denning, C.C. to Finance Department, 10 Jan. 1929, File No. 5(2)F/1929.
Hence, inflation, as defined by the currency authority, did not mean the modern textbook definition, i.e., too much money chasing too few goods. In the inter-war years, when remittances had become an important responsibility for those in charge of finance, inflation had come to mean too many rupees chasing scarce sterling. If the 18d rupee had to be maintained, the physical quantity of the rupee would have to be reduced to raise the rupee in comparative value to sterling. Contraction became an oft used instrument, applied periodically to artificially raise the value of the rupee.

During the slack season, from March to August/September, when the movement of crops had not yet begun, contraction preceded every invitation of tenders for the purchase of sterling by the Government. Having created a relatively scarce supply of rupees, the Government of India brought exchange to a rate at which the Government was willing to buy.¹ A typical

¹ Even during the busy season when an expansion of currency was required by trade and export, contraction was at times considered necessary to assist the S.S. with sterling remittances.

direction from the Secretary of State to the Finance Member would state:

"...Though in April 1928 exchange was stronger than at present...it would seem unduly sanguine to anticipate (that) without contraction it would be possible to supply Home Treasury requirements to anything like (the) extent set forth above through market purchases."

In spite of such stern advice, the Secretary of State's correspondence with the Finance Member demanded measures, however unpopular, to strengthen exchange. Whether this was achieved by cancellation

1. Telegram from C of C dated 8 Mar. 1928 -

The Finance Member and the Controller of Currency persistently reminded the Secretary of State that contraction, and the tightening of credit by raising the bank rate would have upset trade and interfered with the movement of export crops.

"Rise in bank rate to 8 per cent might strengthen exchange somewhat by forcing sale of cotton and might induce Banks to sell to the Government rather than borrow money in India, but the effect on the volume of our remittance would in the long run be very small."

The C of C was not anxious to allow contraction to proceed so far as to push the Bank Rate to 8 per cent as this would force the Govt. to pay a greater price for its ways and means, advanced to satisfy its revenue requirements. Another reason was that an unfairly high bank rate would upset trade, encourage political criticism and eventually decrease the supply of sterling.

Telegram C of C to F.D. 8 Mar. 1928. 5(1)F/28 P.10 Appendix Serial No. 32.
of ad hoc securities, the issue of Treasury Bills, ways and means advances from the Imperial Bank or transfers from currency, the Secretary of State insisted that treasury requirements must be fulfilled despite political protest or financial complications.¹

Directives from the Secretary of State to maintain remittances could often grow so severe that serious differences often arose between authorities in London and the Controller in India. The Secretary of State's requirements of sterling from the Government

¹. There were numerous instances of such conflicts between the India Office and the Fin. Dept. In India, currency officials had to deal carefully with business circles and the politicians, specially in times when monetary imbalances were severe because of remittances that had to be guaranteed to the S of S. Such remittances could damage the Fin. Dept.'s position and harden the attitude of the opposition as well as weaken exchange. Crises were prominent during the depression, when exchange was incurably weak and a persistent flight of capital from India had begun to grow menacing.

See D.O. Telegram XX to SS 6 Nov. 1930 File 1(2)F/1930 generally the differences were apparent in the correspondence between I.O. and F.D.

of India had an important significance politically and default on treasury requirements could embarrass HMG, and compromise the security of their financial guarantees.\(^1\) As a result, the Secretary of State was more anxious to be assured of a steady stream of payments from the Government of India, and was impatient with the innumerable nuances that only the

---

1. A diversion; read what Marx has to say in 1894 on England's balance of payments trade:

"India alone has to pay £5 million in tribute for 'good Government' interest and dividends on British capital etc. not counting the sums sent home annually by officials as savings from their salaries, or by English merchants as a part of their profit to be involved in England...In addition to this, it has interests in foreign railways, canals, mines, with corresponding dividends...."

man on the spot had to contend with. In 1931 on the 6th of May, when the slack season had set in, a fall in world prices, reduced exports and the financial crisis seriously worried the Secretary of State, remittances were hard to come by, and the only alternative the Secretary of State advised Sir Basil P. Blackett was severe contraction:

"...What is required in India is to produce a money famine to frighten bears of exchange and to induce a demand for rupees...I must press upon you the need for pursuing contraction regularly to the maximum extent that your resources allow until a definite influence is produced on exchange."2

1. During 1929 the S.S. made it be known that he expected a good deal more remittances than he had received that year.

"Further by holding out for rates which to us appeared quite arbitrary, a very considerable amount of remittance has been lost."

In an aside G. Schuster wrote complaining not only of the difficulties of providing such vast sums of remittance, but of the frustration of constantly disturbing financial and monetary conditions merely to satisfy house treasury requirements. He wrote of the above

"A very stupid letter. It simply reiterates the old theme that we ought to remit more: but it makes no practical proposals as to better methods."


2. Telegram from Secretary of State, dated 6 May, 1931, File No. 1(8)F/1931, Part I.
The course was clearly unacceptable to officials in India and the Finance Member replied that there were financial priorities in India that could not be ignored, or dismissed in order to satisfy the growing demand for remittances.¹

This concern, however, did not reflect the Indian officials' greater sympathy with the persistent Indian objection to remittance, and the manipulation of currency. The British Indian officials repeatedly explained that their anxiety to satisfy home treasury

1. The C of C was adamant that the India Office did not heed the Indian situation, and remained in the most difficult times, greedy for sterling remittances. The Finance Member wrote to the S of S

"We hold, and we do not think it to be open to question that expansion of currency should be regulated not according to the necessities of our treasury position, but according to the needs of the country; and that we as the currency authority should very carefully guard against the subordination of currency policy to (home) Treasury needs."

Telegram to SO FS, 18 October, 1928 5(I)F/28 p 36, Appendix Serial No. 130.
requirements was perhaps greater than that of the Secretary of State himself, but that the Indian situation had to be carefully dealt with.¹

Their concern was not entirely misplaced. Currency, with its clumsy and inadequate instruments of control, posed enormous problems in the purely financial field, complicated by a fall in commodity values and the revenue requirements of the Government of India. Redundant currency could be removed either through contraction or by offers of Treasury Bills.

¹ D.O. from J.B. Taylor, C of C, dated 5 Feb. 1931.


"The G.O.I. who through their officers in Calcutta and Bombay are closely in touch with the market are in a far better position to judge what action should be taken than anyone sitting in an office in White Hall, and should be given a large discretion."

H. Denning CC to F.D., 27 November, 1928 (5(I)F/1929)
Both were possible only between well-defined limits, as the weakness of the rupee was amplified by a huge floating debt. This put the Government at the mercy of the money market which, if squeezed too hard, might have created a panic, crippled general confidence, and decreased remittances.

Treasury Bills offered to the public at attractive rates of interest, usually solved the problem of contraction without the inevitable political criticism that followed every attempt to restrict the circulation of money. However, treasury bills were

1. Floating debt referred to the liability of the Government to the short term money market in 3, 6, 9 and 12 monthly bills.

"...We have got our floating debt up to the maximum that the market will take. It would therefore be extremely difficult, to say the least, to dispose of an extra 5 crores or so of T.B.'s taken out of the P.C.R. for sale."

The CC had to estimate not only the date of issue, but also the date of maturity so as not to overload the Govt.'s floating debt with excessive issue of bills.

Memo F.D. 4 Sept., 1922 File:
Accts and Fin., May 1923 No. 60-126 Part A.
sold for a maximum of 3 to 9 months after which the capital
had to be returned to circulation, multiplied by the
rates of interest at which they had been sold.\(^1\) Hence,
any large maturity of Treasury Bills could inflate currency
and create a serious fall in the value of the rupee.

1. Telegram to Secy of State, prepared by J.W. Kelly,
C of C, dated 9 May, 1931, also circulated
confidentially in Viceroy's Executive Council.

Easy money between April and early September, 1931
made the Fin. Dept. go in for an active programme
of Treasury Bills. Both the revenue position and
the need to contract demanded such measures. However,
by August/September, 1931, TB's had been pursued so
vigorously 3 and 6 months earlier that the Controller
of Currency wired the Fin. Dept. to complain that

"the heavy Treasury Bill maturities makes
it impossible to control remittances to
any appreciable extent."

The speculative demand for remittances fuelled by
easy money created an enormous crisis in the first
four weeks of Sept. 1931. Exchange was incurably
weak, a position precipitated by Treasury policy
anxious to contract and achieve ironically the
opposite result.

There were additional problems, if Treasury Bills were released to encourage a tight money policy, the bank rate, (if contraction was pursued beyond a point) would have had to be raised. Apart from the difficulties that a fluctuating and unfairly high rate could create, it automatically increased the price at which treasury bills could be sold, and multiplied the cost of ways and means advances that the government was forced to undertake from the Imperial Bank on revenue grounds alone.

The maturity of treasury bills and the annual repayments of ways and means advances, that the Government of India were required to do by fiscal custom, precipitated an indirect demand for sterling. Large inputs of currency into the working balances of the

1. Such contraction could not go on indefinitely, because if the Government continued to raise the discount rate for Treasury bills in order to attract funds from the money market the net result would be that those who purchased the Bills (small Banks for instance) would acquire their funds by borrowing from the I.B.I. and would as a result perpetuate a vicious circle in the demand for money. Revenue difficulties could in such an instance be more easily sorted out by ways and means advances from the I.B.I.

Imperial Bank forced down the bank rate, and credit was relaxed. Since convertibility of the rupee into sterling was assured by the executive order of the Government of India, the flow of money from rupee to sterling and vice versa often depended on rates of interest at which money was serviced in London and India. A favourable rate announced by the Imperial Bank would draw sterling into India, but at times when the Imperial Bank rate fell to 6 per cent or less, money would be transferred to London, multiplying the demand for sterling and complicating remittances.¹

In this particular instance, with maturing Treasury Bills in hand, the Government was forced to allow the

¹ Specially in the slack season when there was easy money and low rates in the market, remittance decreased and the S of S was often tempted to float India Bills in London to realise house treasury requirements of sterling. However, floating India Bills could swell the demand for remittance, a position that the G.O.I. was anxious to avoid, specially if the rates of interest offered in London justified remittance of sterling from India. Such remittance could just as easily damage the rupee loan prospects in July/August and the G.O.I. might once again find itself short on Rupee funds. However, there were instances when the S of S gambled with notifying 'India Bills' even with easy money conditions in India, as in Aug. 1928 when an issue of 6 month India Bills was undertaken by the India Office.


Telegram to SS 15 Aug. 1929 File No. 5(2)F/1929.
bank rate to fall. The Finance Member explained that, as a result of easy money, the exchange markets had begun to hold out for a more favourable rupee rate, and no remittances could be made as long as the market remained weak. Differing rates of interest between India and England had encouraged exchange banks to remit sterling to the Bank of England. The Controller of Currency complained:

"The exchange banks...with the object of transferring money to London where higher rates of interests can be obtained, have been eager to buy sterling without covering their purchases."

There was no reasonable way to prevent a flight of capital, except by raising the bank rate and this was a financial impossibility when the inter-bank call

1. This created a serious problem because as long as the speculative remittances continued Govt. could not satisfy home treasury requirements. The C of C telegraphed the S of S to say

"How long this process will continue is difficult to say, but we are advised that it is imperative for us to refrain from an attempt to make any remittance so long as it (transfer of money to London) goes on, and market remains weak, as acceptance of tenders at low rates would merely increase weakness of the market."

Telegram to S.S. 27 Jun. 1929 5(I)P/28 P. 20
App: Serial No. 82.

See also Telegram from C of C 8 May, 1931
D.O. from J.B. Taylor 18 Mar. 1931.
rate, between exchange banks and the Imperial Bank, dropped to less than 3 per cent. It could have cost the Imperial Bank enormous sums of money, that would have been difficult to justify to its shareholders, specially when such policies materially reduced its dividends declared each year. The Government could merely wait or contract currency after a reasonable interval, after the repayment of ways and means advances and so encourage the bank rate to adjust to local conditions.

Any attempt to create a famine of currency would necessarily entail a famine of credit which bred financial consequences that worked against itself.¹ The entire dilemma of the Government of

1. The Indian money market was so dominated by the Government that the sale of T.B.'s was inversely proportionate to the official restriction of credit. Before 1923 when the purchase of sterling through the issue of councils was an accepted procedure, Council sales expanded currency in India and encouraged the buying of treasury bills at rates reasonable to the Govt. of India. However, if the sale of councils was interrupted, T.B.'s would be that much more difficult to sell, as the lack of Council Bills would presume tight money.

India's financial policy was that manipulation to sustain the 18d rupee, required in time more and more manipulation till currency policy became counter-productive and remittances decreased.

A substantial restriction of credit by the Imperial Bank, for instance, would critically depreciate Government securities, and devalue treasury bills held by the public. Even if the Government was prepared to face a financial panic, a money famine would not necessarily be the result, as large resources existed outside the control of the Imperial Bank, and it was foreseeable even to Indian officials that the market could obtain additional supplies of credit by refusing to renew Treasury Bills.  

---

1. Similarly (Ref. above) if Treasury Bills were issued immediately after the Rupee Loan, the high rates that were usually offered to draw surplus funds from the market, in years of exceptional ease, depreciated all other Government securities reducing their saleability. In 1929, when money was so abundant that it was practically unlendable, the managing governors complained bitterly of the efforts of the Fin. Dept. to begin an issue of 3 months bills. The C.C. wrote

"The I.B.I. hates T.B.'s not only because they cut into their deposits but because of the effect on their security holdings."

D.O. from J.B. Taylor to F.D. 24 Jun. 1929.
Telegram to S.S. from F.D. 9 Jul. 1929
D.C. from J.B. Taylor to F.D. 13 Jul., 1929
File No. 5(2)F/1929.

Clearly to restrict advances and to deny the market credit was not an entirely practical remedy. Contraction could not be pursued beyond an absolute limit. The minimum of cash which the Imperial Bank could work with was eleven crores and if by contraction the Government reduced the bank's cash below this figure, the Imperial Bank would have to borrow from the Government unless the Government was prepared to see the bank close its doors.

Further, it was not always easy to deal with the Imperial Bank on all currency matters. Unlimited manipulation of currency could compromise the fiscal function of the Imperial Bank unless caution was exercised. Avenues of investments of surplus funds of the Imperial Bank were not easy to come by. Other banks and the investing public serviced their funds by subscribing to rupee loans and treasury bills. But, as both short-term and long-term loans issued by the Government of India were used as devices to contract currency and remit sterling, such loans had no productive functions, and were merely promises to pay from future revenues increasingly pledged in this manner.¹

The Imperial Bank was often discouraged from investing in Government securities, merely because it would have increased the Government's responsibility to service such large funds, when it could just as easily effect contraction by deducting large sums of working capital from the Bank's balancing. Sir Osbourne Smith complained more than once in 1931, that as trade demand was much lower that year:

"...that other banks are investing their surplus funds so released in Treasury Bills, and that it was unfair that the Imperial Bank should be entirely precluded from doing the same."1

Smith reminded the Controller of Currency and the Finance Member that he was, to a certain extent, responsible for credit control and was alarmed at his low trading profits. In March, 1931 he warned that unless he could find some investment for his surplus funds, Osborne Smith would have had to doctor the Bank's dividend during that summer.

1. The responsibility towards exchange often made it necessary to tighten slack money during the inactive months of July and August making the Bank rates ineffective, and incurring high losses to the Imperial Bank which had to service its liabilities at an exaggerated artificial rate. At such times the I.B.I. would advise the G.O.I. to abandon T.B.'s and contract, which the Government was unwilling to do as its Treasury requirements demanded short term lending rather than outright cancellation of currency. The Bank on the other hand rejected open market operations as they tended to depreciate existing securities, were ineffective in making the Bank rate effective and increased the Bank's own liabilities to the money market. In 1929 Osborne Smith wrote to the Finance Member saying,

"We assure you that we have every desire for real cooperation but we think you should realise we are the best judge of credit and also probably of the exchange position."

The Fin. Dept. caught between an India Office responsible to the British Cabinet and an Imperial Bank to trade and commercial interests in India, was often uncontrollably bound by conflicting demands, inefficient monetary authority, and frightening consequences of severe monetary imbalance.


The deflationary policies of the Government were so unpopular that the Imperial Bank had not only to face accusations of 'subservience to Government', but suspicion was enough to split the Board and divide the vote of the Managing Directors. Some of the latter like Banbury, strongly opposed fluctuations in the bank rate.\(^1\) Controversion of this sort encouraged, what Indian officials called 'extremist opinion' and contributed towards speculation in the exchange markets, and importers who bought larger amounts of forward exchange, and the government found it difficult to buy sterling at favourable rates.\(^2\)

---

   The dissident Directors: Banbury and Later P.T./\(^5/(2)/F/30.\)

   "They (Managing Governors of the I.B.I.) are being shot at on all sides...and there can be no doubt too that the 1s4d wallas realise that this is likely to be their last charge and are waiting to raise as great a hullabaloo as is possible, at any action taken to defend exchange."

The Government should not, advised the C.C., press the I.B.I. too hard against its declared duty towards the genuine requirements of trade and commerce.

D.O. from J.B. Taylor, C.C. 16 Nov. 1929,
File No. 5(2)F/1930.
At such times Osborne Smith was forced to retreat from active cooperation with the Government declaring that as the Managing Governors were not prepared to take the responsibility for raising the Bank rate, the Government would have to categorically declare that the rise of the Bank rate was due to Government action in raising the rate of interests of loans from currency. ¹

Hence, it was either possible to

(a) regulate the bank rate and that of Treasury Bills by a sufficient margin over foreign money rates to attract short money to India, or²

¹ Telegram to S of S for India, London, dated 10 Feb. 1929.
² In 1930 the unbalanced monetary conditions encouraged the Fin. Dept. to consider whether it would be worth bringing down the prices of their securities steeply to a point where it might pay the exchange banks.

"to bring out funds and invest in Treasury Bills from a purely profit point of view."

The alternative at that time was rejected because the C.C. felt it would not only complicate the GOI's treasury position, it would also depreciate all other securities on the money market.

"I would not make too drastic an increase in the yields both on grounds of expense, and also from the point of view of the securities market."

(b) to force an abnormal increase in money rates with the purpose of drastically contracting currency and creating a money famine.

Alternative (a) was the course usually followed, but there were serious problems involved. In order to be effective for the purpose of checking the export of capital, money rates would have had to be raised to a level which would make Government securities practically unsaleable,¹ and even if such a state of affairs did not produce a financial panic, it would have seriously impaired the ability of the Government to raise credit. Rupee loans and the sale of


See also Telegram from Viceroy to Secretary of State for India dated 7 Feb. 1929.
Treasury Bills would have decreased considerably, and if the Government risked large expenditure on interest charges, an expansion of currency would have been inevitable. The Government's revenue position would certainly have grown unbearably complicated and the remedy would probably have been more frightening than the disease.

1. In Feb. 1929 the S.S insistence that the Bank rate be raised to 8 per cent to effect remittances, disturbed the Managing Governors who wrote to warn the S.S. that the consequences of severely restricting credit would be enormous.

"In connection with the proposal to raise the Bank rate to 8 per cent we wish to record our views against an increase at the present juncture. We do not consider the exigencies of the situation at present, demand such burden on agriculture and industry, especially at this time of depression... We are still of the opinion that the detrimental effects on your near future (Treasury Bill) and distant future (Rupee loan) prospects will more than offset any possible temporary benefit from exchange."

Alternative (b) could be politically damaging. Very high money rates would have considerably increased the Trade Depression which was already the most serious factor in the Indian situation and recognisably contributed to the difficult political situation that the Government was faced with during 1930-34. Even in relatively more quiet times the over-valued rupee was a serious complaint that could no longer be ignored, and certainly not entirely disregarded by further currency contraction.¹

¹ When in Feb. 1929 the S.S. telegraphed the Fin. Dept. about his anxiety over the lack of remittances, he advised a stiffening of money rates despite the fact that money was tight and the Bank rate stood at 7 per cent. Indian officials were noticeably reluctant to carry through a further contraction raising the Bank rate to 8 or even 9 per cent as the Govt. would have had to take the entire responsibility for the rise in the Bank rate. The F.D. wrote to the C.C. that the course advised by the S.S. was dangerous primarily because:

"The commercial community are sure to raise a storm of protest on the grounds that the Bank rate has been raised simply to give strength to exchange. I think this will give another opportunity for propaganda against the 18P ratio."

Telegram from the S.S. 5 Feb. 1929, with endorsement to the C.C. and Deputy C.C. from K. Sanjiva Rao, 6 Feb. 1929, File 5(2)F/1929.

See also D.O. Telegram XX to S.S. 18 Dec. 1931, File 1(8)F/1931.
Government of India's Revenue Requirements

The Secretary of State did not entirely grasp the delicate balancing act that those in charge of currency were forced to perform. Hence, despite the financial difficulties that the Govt. of India had to undertake in order to support remittance, the Secretary of State was emphatic that treasury requirements must continue to be satisfied, whatever the cost. In a telegram to the Finance Member, advice

1. Officials in the Fin. Dept. were worried whether the exchange priority of currency policy would not drastically interfere with their revenue requirements. Cook (Secy F. D.) wrote to the C.C. McWaters saying:

"Does not Kisch (Fin. Secy. I.O.) make the fundamental mistake of assuming surplus resources, and forgetting the fact that so long as we are working to a large revenue deficit, a policy of contracting the currency, even if it is commendable in itself, is a council of imperfection."


See also

"Moreover as long as we are meeting a considerable part of our expenditure by borrowing, deflation must remain largely unreal, for we are cancelling currency notes on one hand, and by increasing our borrowing in order to make this possible, are at the same time creating material for fresh credits."

It could not have been put better.

F.D. to S.S. 20 Oct. 1922 ibid.
was given to the Government of India to free themselves from indebtedness to the Bank by speeding up the issue of the Treasury Bills even at the cost of higher rates. If this advance had been accepted there would have been a stiffening of money rates in India at the cost of the Government of India's sincere indebtedness and its greater liability to foreign creditors.' The Secretary of State, however, declared:

"If as I believe this course of action is the right one for an (proposed) independent (currency) authority, I feel the Government (of India) with its paramount obligation in regard to currency and exchange would not be justified in subordinating those obligations to its borrowing needs." 1

As a result, a persistent problem that crept up annually was the rupee loan that was necessary to support Government finances, and postpone the ever present threat of financial insolvency.\(^1\) However, a rupee loan that could draw off funds to the tune

---

1. Indian officials in charge of currency were well aware of the fact that the Government's revenue requirements were incompatible with the continuous demand for remittances from the S.S. Specially at a time of a strong exchange (equally so when exchange weakened), the Government had to finance its large purchase of sterling which meant that either:

1. "...impress the market by our ability to dispense so far as possible with borrowing from the public and

2. "provide in advance a good proportion of the remittances required by the S.S. for the next year with the object of postponing sterling borrowings to the latest possible date."

The Finance Member added

"It is obvious that these two policies are really inconsistent with each other, and if we hold firmly to the former, I have considerable doubts whether we shall be able to effect the latter."

D.O. to Denning C.C. 24 Oct. 1924.

File Accts. and Fin. April 1924 Nos. 57-117 Part 'A'.
of 14-20 crores in long-term Government bonds guaranteed at a fixed rate of interest, could not be undertaken along with any serious deflationary policy to encourage remittances. Any 'Redundant Currency' drawn out of circulation would logically make it that much more difficult to successfully negotiate a loan offer, unless proportionally higher rates of interest were offered. ¹

Given the circumstances, it was either possible to tighten credit and exchange by contraction and treasury bills before the rupee loan, or to issue

¹. Telegram to S of S, dated 12 May 1929, File No. 5(2)Finance.
the loan first and the follow it up with measures for further tightening up of credit as may then have been found necessary. Indian officials preferred the second remedy, though it meant working overtime, fulfilling the Secretary of State's requirements held in abeyance for two months before the rupee loan.

---

1. Yet draconic contraction was impossible and neither alternative really worked. As a result, when credit was in serious danger of getting out of hand, the Secretary of State's requirements were satisfied by the ultimate and increasingly used instrument of the sterling loan. These loans contracted in the London money market, were guaranteed by the Secretary of State which was an important reason why they were successful.

2. Even this remedy had its disadvantages. S.S. warned the F.D. in 1929.

"If however, as you suggest, contraction is not carried out until after issue of the loan it would then probably have to be undertaken on somewhat drastic lines in order to produce the requisite effect. The consequences of such a post-loan contraction would be a still further scaling down of prices of previous issues and a depreciation also of the price of the new loan. This would seem certain to intensify present dissatisfaction effect of which would be likely to prejudice your issue in future."

Telegram from S of S 26 Apr. 1929 5(2)F/1929.
Another reason why the rupee loan was difficult to negotiate was because there existed an important extra economic influence on Indian exchange which the Government of India had to concede to, if it was to effect remittance as its once weekly call for tenders. Since sterling had to be purchased from exporters willing to sell to the Government of India, no price could be fixed or legislated by the Government at such auctions either in Calcutta or in Bombay. Exporters anxious to acquire more rupees to sterling could stall the Government despite Government's obvious authority over currency as the largest buyer of sterling in the exchange market.

From 1926 onwards, with shrinking exports, the rupee was so delicately balanced that a general lack of confidence in the 1s6d rupee could make sterling unavailable either in Calcutta or in Bombay for weeks, seriously unsettling exchange. ¹ In 1926, when the Royal Commission's

---

1. In August 1928, the enormous borrowings of the Government, seriously disturbed the money market which, as a result prepared for easy money in the coming months, a presumption that would have weakened exchange. The Government, anxious to avoid this, was prepared to release unofficially a calculated rumour that its borrowings were in part only temporarily and mostly in the form of ways and means advances. The Controller advised the Fin. Dept. that it was not to reveal under any circumstances the exact magnitude of Govt's subscription to the rupee loan, as they were anxious as to the ability of the market to drastically alter exchange and embarrass the Government. The Controller wrote about his attempt to calm the Bombay money market.

.../contd.
recommendations were being discussed in the Assembly, the
Government, in spite of contradictory suggestions from
H. Denning, the Controller of Currency decided to postpone
contraction till well after the debate. The Finance Member,
Sir Basil Blackett, recognising the influence of politics
on the exchange market, explained that in spite of the easy
money situation, and the difficulty in satisfying the
Secretary of State's requirements for a few months, he must
promote a calm atmosphere for discussion of the Commission's
report.¹ H. Denning complained that "from the Government's
reply I gather the political considerations so far outweigh
financial considerations, that they are perhaps prepared to take
the risk of easy money during the cold weather." This

(footnote contd.)

"I hope that the market will accept my explanation
that the discrepancy is due to ways and means
advances outstanding... it will be most unfortunate
if we are tackled seriously on the point or if
anyone gets wind of the fact that Government made
large subscriptions to the loan. (In an aside
a Fin Dept official wrote: "I suppose it is better
not to give our Bombay friends even a grain of
comfort....")

See Telegram to S.S., 20 March 1926, File No.53/F/1926.

¹. Telegram to S.S., 26 March 1926, ibid.
apparent concession to political considerations was actually a choice dictated by circumstance. 4

Political unease and the slightest lack of confidence in the exchange rate or the rate at which the Government was willing to buy sterling could drop the rate and reduce the amount of sterling available for Government purchase. 2 A refusal to sell did at times acquire a political flavour and the Government would find itself acutely embarrassed by the lack of response to a rupee loan, even though announced at favourable terms. 3


2. In 1920, when the sale of Reserve Councils created in furore in the Bombay commercial world, because of the serious disturbance to trade that Government policy had brought about, the Fin Dept wired the India Office, warning the S.S. of the gravity of this commercial opposition.

"We have been informed confidentially that a movement is on foot to boycott all our financial operations and even invoke the Satyagraha organisation. In view of the large extent to which we depend on the Bombay money market for the success of our financial operations, the significance of this movement will not be lost on you."

From A. V. V. Aiyar (Asstt Secretary to GOI) Fin Dept to S.S. Telegram 7 March 1920.

File No. Acc. 13 & Fin, Jan. 1921, Nos. 6-104, Part A.

3. Telegram from Viceroy to Secretary of State, dated 12 July 1928.
Hence, even though theoretically, the Government could in effect contract, expand, issue treasury bills, undertake ways and means advance, or issue rupee loans, it had to take care not to unduly disturb exporters who sold sterling on the two exchange markets. There was no doubt, that the individual ability of such exporters who sold sterling on the two exchange markets, to trip government and embarrass it financially was small. However, this influence especially during the depression years, was not negligible. It was, repeatedly, the cause of differences between the Secretary of State in London and the Controller of Currency in India. H. Denning often complained that unless the Government was prepared to adopt a consistent currency policy towards the exchange markets, speculation could become a serious problem, serious enough to disturb regular remittances. In a letter to the Finance Member, H. Denning wrote:

"... the markets will not have any confidence in the future as to what Government's action may be, and there certainly will be general criticism of Government manipulation. I myself think that such criticism would be justified, because I think it unsound to contract sporadically without any consistent policy. Quite apart from criticism on financial grounds you will be able to imagine for yourself the bitter criticism from Bombay exponents of the 16p rupee."

It was not that such criticism was harmful as a vocal or written petition designed to discredit the Government. Its influence in amplifying speculation on the exchanges and making remittances harder to come by, made the Government very aware of what they euphemistically called 'political considerations'.

---

1. In February 1929, the rumour that the 1s6d would be abandoned led to a nervous, unpredictable money market. The C.C. advised the S.S. that if large purchases of sterling were attempted it was bound to weaken exchange.

"...in the present atmosphere of rumour and complaint regarding ratio we should regard it as almost disastrous if we had to drop below 1s6d at this season of the year and for the present we shall propose to stand on 1s6d as minimum. We must, however, be prepared for the possibility of the market again trying to force rates down by holding off temporarily, and accordingly we shall be glad if you will let us know at once for how long you could do without remittance from us and carry on in such an eventuality."

Telegram from Viceroy (Fin Dept) to S.S. 7 February 1929 File No. 5(2)F/1929.
The Round Table Conference, for instance, despite the peripheral interest that it generated on the ratio controversy, unsettled the Indian exchange markets for months before any decision on the ratio was actually taken. An article in the "Stateman"\(^1\) on 14 January 1931 speculating on the probable fate of the exchange ratio believed that a responsible legislature would now favour a return to the 16d ratio.

Typically, the small news item was enough to disturb market equilibrium. J.B. Taylor remarked in his weekly report to the Finance Member:

"This has been a depressing week, both from the point of view of exchange and trade generally. Practically, no bills have been shown here and the article in the "Financial News" which was telegraphed out had a depressing effect on the market. There have also been bazaar rumours of a change of ratio in the budget. Though this has hardly effected the exchange banks or bigger houses...it has led to bazaar demands for forward purchase."\(^2\)

---


The 'bazaar rumour', however, became so effective that by the 7th of February 1931, exchange took a turn for the worse when the Bombay market responded to Birla's stampede of the moderates in FICCI into insisting on the immediate transfer of currency control. Birla confidently predicted that with the Round Table Conference delegates in London the result would either be a deadlock, or a weakening by the Government. Exchange in the days that followed dropped to 1s5.4d and the only seller of sterling was the Yokohama Specie Bank, a Japanese Bank, that was willing to buy rupee for the buying of raw cotton.¹

More significant was that the amount available was only £29,000-30,000 from a normal weekly remittance of £500,000-1,000,000.

With the announcement of the budget by the Finance Member and a personal message from the British Prime Minister, assuming the maintenance of the ratio at its legislated 18p, exchange improved,² but once again

---


plummeted when the radical delegates on their return from London declared that complete control of currency policy would be in the hands of an Indian Finance Member as soon as a Reserve Bank was established. These fluctuations were financially troublesome and to steady exchange the Government was forced to sell sterling until uncertainty due to possible political developments was removed.

The way out: Sterling Loan.

To overcome many of the difficulties that the Government was forced to contend with, Indian officials borrowed sterling on the London money market to fulfil treasury requirements that they could not otherwise hope to satisfy. With the falling trade balance, small


If the remittance position grew uncomfortable, it often became necessary to contract a sterling loan and ease exchange. In 1928, for instance, C.H. Kisch advised:

"A fortnight ago, moreover, the remittance position did not look particularly promising and it was, therefore, decided as stated in the S.S. first telegram to arrange for an early sterling loan."

1928 was a difficult year for the Government of India, as the boom years of 1925 and 1926 had turned to a mild slump, specially in primary produce that had begun to drop in price on the world market in relation to industrial commodities. After 1930's the recourse to sterling loans was rejected in favour of encouraging gold exports. Sterling borrowings were as a result extremely important in correcting exchange imbalance in the 1920's.

budget surplus and currency manipulation beginning to grow counter-productive, the Government of India had to balance revenue against expenditure and satisfy remittances by appearing in the London money market for sterling funds.¹

This was only possible and, in fact, encouraged because of the larger framework of Imperial monetary unity which allowed both the colonies as well as the dominions of the Empire, to regard London's short-term

1. Sterling borrowing on the short-term market was also actively resorted to, in order to restore exchange imbalance. "India Bills" raised by the India Office in London had the advantage in that not only did it postpone the demand for sterling from awkward times of the year like the middle months of the slack season, it also made the issue of Treasury Bills in India unnecessary. This allowed the Fin. Dept. to relax their deflationary pressure on currency and proclaim how responsible they were in their commitment of easy money to the public. However, Indian officials were always cautious as the incoming 'busy season' might not have been one of the active trade, in which case 'India Bills' would be that much more difficult to repay.
and long-term capital markets as virtually their own.¹ India was promised favourable rates of interest, not to a small degree because of its high credit standing on the London money market.² Indian credit standing was substantially influenced by our trustee status which allowed India to raise loans of over £5 million sterling at rates of interest of 3 to 3.5 per cent lower than what would normally have been charged to countries outside the empire. The security of Indian loans was because of our peculiar monetary status in relation to Britain.

(a) India kept her currency reserve and balances of bullion at £50 million in London, which in a way amounted to a pledge for the discharge of her sterling obligations.

¹. The S.S. in defending the system of Council Drafts for the purchase of sterling, rejected all other alternatives on the grounds that:

"The sale of council drafts in London strengthens the link between Indian finance and the London market, on which India depends for large contributions of capital for the development of the country. It does this by maintaining in London, not only the free market for rupees, but also an intimate and increasing association with India's currency and credit requirements in the broadest sense."

Despatch from S.S., Indian Office, 12 Apr. 1923, File No. Acc. & Fin. - April 1924, Nos. 57-117, Part A.

². In the immediate post-war period - the early twenties, the reason why debt service had become such a high priority item in India's remittance operations, was because the Government of India's continuing budgetary and revenue difficulties made it preserve its high credit standing in London. Future loans to cure embarrassing deficits that invariably arose were made possible only by servicing all past and present capital liabilities with the promptness and regularity that the S.S. insisted on.
(b) India had always made a very liberal provision for debt redemption—a provision which was sometimes not warranted by the unproductive portion of her debt—simply in order to maintain her credit with her creditors both in India and England.

(c) India had never been a defaulter like Russia who had repudiated all her British debts, or Turkey and China who had so frequently not been able to meet their obligations punctually in respect of interest payment of their repayment of principal, or like Australia whose borrowings in London during the 1920's amounted in effect to the payment of her interest bill in London and could not claim either large financial benefits or extensive promotions of Imperial trade.

(d) The money raised in England on behalf of India was, to some extent, spent in England on the purchase of railway materials or to repay the old investors on Indian railways. In the latter case, it did not cause any disturbance to the London money market, and in the former it tended to promote British exports to India.

Of course, the most important condition why India's credit standing was seldom questioned was because the revenues of India and the properties of the Government of India were administered and controlled by an Anglo-Indian bureaucracy who owed their ultimate responsibility to His Majesty's Government in London.
However, with the collapse of trade in the early thirties, sterling was appreciably over-valued at par with gold. Even off the gold standard, the rupee was linked to sterling on the condition that it did not depreciate,¹ and once the Government forbade the payment of sterling, loans from London without the tacit guarantee of H.M.G. were an impossibility.

1. This was promulgated by Ordinance VII of 1931 titled 'The Gold and Sterling Sales Regulation Ordinance, 1931'. The ordinance was specifically designed to control the almost unmanageable flight from the rupee once sterling was delinked from gold in September 1931. Ordinance VII was repeated in January 30th 1932, as soon as the S.S. was assured that sterling would remain strong and that the flood of speculative remittances had decreased. F.D. telegraphed the S.S. to support the repeal on the grounds that:

"Our sterling position has been greatly strengthened...We admit that exports of gold are almost entirely responsible for the change in the situation, but exports seem likely to continue in spite of Congress propaganda...We think that the desire to export capital has considerably decreased since September last. Confidence in the maintenance of the sterling value of the rupee has increased while unsettled conditions throughout the world tend to discourage transfer of money."

Once the S.S. was convinced that the rupee would not drag on sterling, ordinance was cancelled.

The Government of India was actively discouraged from undertaking any further sterling debt, which enormously complicated its balance of payments position. Manipulation of currency could not so much as even hope to support the rate, unless contraction was undertaken to depress gold prices and encourage the export of gold.

Gold Exports.

This was exactly what occurred. To support remittances, contraction was pursued which ultimately catalysed the huge export of gold that once again generated favourable trade balances and corrected exchange.¹

¹. Denning to F.D., 23 Oct. 1931.
   Denning to F.D., 24 Oct. 1931.
   C.C. to S.S., 26 Oct. 1931
   C.C. to F.D., 27 Oct. 1931
   J.B. Taylor, C.C. to F.D., 7 Nov. 1931
   Telegram XX to S.S., 10 Nov. 1931
   D.O., J.B. Taylor, C.C., 28 Nov. 1931
   D.O., J.B. Taylor, C.C., 18 Dec. 1931
   File No. 1(8)F/1931.
The export that began with the Secretary of State's decision to link the rupee to sterling in 1931, was encouraged by the large quantities of 'distress' gold that reached the market disgorged from hidden hoarded stocks. The Controller of Currency, as early as 7 Apr. 1931, had written to the Finance Member, enclosing a private and confidential letter from the Manager of the Imperial Bank, reporting that gold had been trickling back to Bombay from Lahore, Jullundur, Amritsar and other agricultural centres of Northern India because of the serious economic distress among the peasantry. E.J. Dawson,

1. President of the FICCI dwelt at length on the export of gold.

"The phenomenon is particularly distressing because the movement of gold is more or less promoted not by any offer of speculative profit but by economic pressure of forcing the poverty stricken people of this country to part with their savings in the form of gold ornaments."

Proceedings of the 5th A.C.M., 27 Mar. 1932, FICCI, p 6, President's speech for the year, Jamal Mohamed Saib.

Manager, Imperial Bank, Punjab Division, had reported in his letter forwarded to the Finance Member:

"...as a result of the continued depression and low prices of grains and other produce gold ornaments were to a considerable extent offered on the market. These ornaments were purchased by the gold-smiths, and after a process of local refining, the gold became available to meet the currency demand and, in fact, stocks were soon accumulated. Thus, in the 2nd half of 1930, a reverse gold business was noticeable, that is to say, Amritsar became an exporting market of the locally refined gold."

A number of such reports of the Controller of Currency and the visible proof of large gold stocks accumulating in Bombay and Calcutta, encouraged Indian officials to consider selling gold in the Gold Standard Reserve in London to offset the gold received in India. It was quite clear from the number of Demi Officials between the Controller of Currency, the Finance Member and the Secretary of State, that the sale of gold was not being debated upon to satisfy the revenue requirements of the Government of India. The sale of gold was more specifically linked to,

(a) Remittance and exchange;
(b) The large requirements of gold that the bank of England required to strengthen the position of the pound sterling on the world market. 1

Even though the Secretary of State demanded that his suggestions of transfer by sale of gold from the Gold Standard Reserve to the Bank of England be immediately acted upon, Indian officials were cautious. They could only allow the transfer and sale of gold if exchange strengthened to a rate reasonably above lower gold point. They could not allow criticism or political action by proponents of the 1s4d ratio to weaken exchange at a time when the Government was vulnerable

1. Telegram to the S.S., 24 Apr. 1932. File No. 1(8)F/32 FICCI passed a resolution which said:

"It (Export of Gold) has enabled her (United Kingdom) to effect repayment of credits advanced by the Federal Reserve Bank of New York and the Bank of France without drawing upon her gold. "The Indian gold influx probably saved the situation." The financial correspondent of a well known British Weekly adds in a happy vein 'if Indian hoards continue to be released it should be possible for the Bank (of England) to build up fresh resources for further payments. The policy of unrestricted export of gold from India will help Britain to redeem her (International mortgage)."

to criticism of allowing 'gold exports' from India.¹

The Indian officials seriously worried by the political resolutions against Govt. monetary policy, pleaded with the Secretary of State that if the export had to be undertaken, let the transaction not be interpreted as one of expediency but as a sound economic principle worked to the best interests of India.

1. "In view of influx of gold India, we think that if a temporary strengthening of exchange occurs we should take the opportunity to sell gold held in the Gold Standard Reserve in London. We realise that such action would be resented by Indian opinion and might be used as an excuse for renewed agitation against the ratio which might temporarily weaken exchange, but we feel that by all its merits that is the right course, and we can justify our action by pointing to recent influx of gold in India, exceeding the amount sold in London. We should be inclined, therefore, to disregard the possible reaction of public criticism, at least if exchange at the time is well above the lower gold point. If the opportunity occurs, we think it would probably be advisable to put through the operation rapidly and issue a communique explaining the reasons for our actions as it was completed. We should be glad to have your views to this question and know if an appreciably higher price could be obtained if gold was sold in instalments...."

F.D. to S of S 24 Apr. 1931 1(8)P/J-D 31 Part II by 24 Feb. 1936, in reply to a question in the Legislative Assembly by Seth Govind Das, that the total exports of gold from 1931 had amounted to 270.5 crore of rupees.

The reply from the Secretary of State was predictably impatient. He argued that criticism could perch on any vantage point and that if exchange was allowed to strengthen before the transfer, proponents of the 1s4d ratio could argue that as remittances were improving, the gold exports were entirely unnecessary. Nevertheless, it is quite clear that the Secretary of State was anxious to facilitate the transfer because of his remittance requirements.¹

¹ "As regards the sale of gold in London, I welcome the proposal and suggest it might be well to act promptly since the step would then most naturally be connected with recent acquisitions of gold in India. I doubt if criticism would be materially lessened if action were postponed until exchange is substantially above lower gold point. Seeing it could then be argued that there was no particular reason for India to reduce its gold hoarding in view of improved remittance prospects which would have arisen."

To Fin. Dept. from the Secretary of State, 26 Apr., 1931, File No. 1(8)F/1931, Part II.
Certainly the export of gold was allowed by Indian Officials to help strengthen remittances and bolster exchange; it was also a measure that considerable profit to the Bank of England when sterling and the position of the pound on the world money markets were shaky.¹

The Imperial Perspective:

Most of all it supported the structure of an Imperial monetary union that Britain had become

1. "With the present situation of sterling exchange the most satisfactory method of disposing of gold would probably be to sell the entire holding to Bank of England. The advantage obtained from prompt payment with immediate starting of interest is likely to exceed possible gain through instalments. I suggest that when decisions as to sale and time have been taken, detailed arrangements should be left in my hands so that the course most advantageous to Indian interest in light of existing circumstances may be taken. If you agree...."
particularly attached to during the inter-war years. The arrangements that perpetuated the 'sterling area' and the unrestricted movement of Empire currencies allowed Britain to utilise Empire trade to liquidate her traditional debts.

1. Currency Boards like the currency office in India and Central Banks, in both the colonies as well as the dominions, regulated local currency to preserve intra-imperial monetary relationships. Some Empire officials went as far as to suggest an all empire currency, that was struck down for no other reason than that it was an inelastic scheme that would have mechanically communicated fluctuations, without having the capacity to absorb and reduce monetary shocks as did the present system.

The advantage of a structure of local currency boards was that adjustment could be continuously reviewed by restricting or expanding lending, and allowing Banks to supervise the position of international reserves. Unless commodity trade varied enormously and radically disturbed exchange, currency boards in collusion with Banks under their control had, as a result, a relatively large number of alternatives by which equilibrium could be achieved.

In the special case of India, these controls were often used with draconic intent, sending the government teetering to the edge of Bankruptcy, and financial embarrassment.\textsuperscript{1} In the Southern Dominions where Whitehall could not afford to disregard the special position of his Majesty's white settlers, monetary domination of sterling was not entirely absent. Even though the strong trade links of the pre-war era were loosening, incidents such as the return to gold demonstrated how inefficient, imperial monetary union could actually become.

\textsuperscript{1} A proposal for an Empire currency was elaborated in a memorandum to the colonial office and treasury in 1917 by J.F. Darling, formerly an exchange Banker in India and later a Director of the Midland Bank. Darling's scheme was for a single Empire currency based upon 'Imperial Treasury Bills issued by Empire Governments. R.G. Hawtrey pulled it apart saying that it differed little from the existing basis of sterling links which at least offered some local cushioning against severe trade and monetary disturbances. However, the fact that the scheme was at first favourably considered by Hawtrey, shows how widespread and sometimes naive, was this desire to return entirely to pre-war monetary arrangements. ibid. pp. 72 - 80.
During 1920-23, the large borrowings in London strengthened dominion currencies, specially in New Zealand and Australia, but improved exchange, very much as in India, was brought about at the cost of restricted note issue, that fostered dissatisfaction among local businessmen. In New Zealand, bank nationalisation became an election issue. In South Africa, the deflation, consequent to a general pressure to return to gold, generated serious problems of unemployment which ultimately caused the fall of the Smut's government in 1924.

After 1925, with an overvalued sterling on pre-war parity with gold, matters deteriorated even further with terms of trade going against countries that exported primary produce. Empire trade unable to support sterling caused a flight of gold that generated additional problems of liquidity multiplying the overall monetary strain on Britain's slender resources.

It was not financial orthodoxy alone that was responsible for the resilience of the Imperial monetary machine that perpetuated the 'optimum currency area'. The maintenance of the ability to divert balances of empire countries by consuming their primary products and then holding their unspent, non-empire,
trade earnings, immeasurably strengthened Britain's ability to support herself through the Depression and the Second World War.

Admittedly, the machinery of Empire remittance, sterling payment and international debt redemption agreements, was not as visible as the efforts to rebuild Empire Trade. The Imperial visionaries were of several kinds. Montague Norman, L.S. Ameny, Neimeyer, and Bradbury were very different from those like Lord Bearerbrook, J.H. Thomas and Sir Phillip Cunliffe-Lister who saw preferential tariff systems as the cure for Empire development. This is one reason why a deeper investigation might reveal a fundamental difference in the attitude of the colonial office towards the Ottawa Economic Conference, Britain successfully discouraged a revaluation of empire currencies, and the serious temptation to switch to the Dollar was overcome by the traditional, if slightly worn, attachment to the Crown. If the right to free and unrestricted movement of capital was to be preserved, then, argued those like Beverbrook, Britain should encourage several parts of the empire that were more inclined to trade with each other than with foreign countries.

The sterling system was a part of this framework, albeit one of the important elements. The jealousy with which it was preserved, and the enormous influence that this had on the monetary attitude to Empire colonies, specially India, was undeniable.