
ARTICLES

*Gold and Empire: Britain and India in the Great Depression*¹

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"If India demands payment in precious metals to an extent that is unreasonable, the British Government will be doing a doubtful service to the world in protecting (her) against the marauding invaders whose raids in olden times served the purpose of relieving her of superficial hoards of gold".²

The bearing that Britain's external liquidity problems had on the design of the Indian currency system has been well-known since Marcello de Cecco's pioneering work on the pre-1914 gold standard.³ His story has even greater validity for the inter-war years. Britain's objective of affecting economies in the monetary use of gold continued to be pursued more vigorously in relation to India than to other countries.⁴ Besides, there was a new element in this period which had been absent in the earlier one. Her more severe external balance problems which forced Black-

¹ I wish to thank K.N. CHAUDHURI, MEGHNAD DESAI and CLIVE DEWEY for comments on the Ph. D. thesis, on parts of which this paper is based. Thanks are also due to SANJAY SUBRAHMANYAM and A. JOSEPH JAMES for comments on an earlier draft of the paper. The usual disclaimer applies.

² PUBLIC RECORDS OFFICE (PRO), T160 18/F. 571, Blackett's memorandum "Indian Exchange and Currency Committee", n.d. but January 1920.

³ M. DE CECCO, *Money and Empire: The International Gold Standard, 1890-1914*, Oxford, 1974.

⁴ G. BALACHANDRAN, "Britain, USA and the Indian Gold Standard", *Economic and Political Weekly (EPW)*, August 1989.

ett at the outset of the period to recall wistfully the virtues of an earlier mercantilist era, also led Britain to use the expedient of deflationary macro-policy to determine the absorption and release of gold (the primary reserve) by India on the *private* account.⁵

India had long been known as a "bottomless sink" of precious metals. In a good year before the First World War, her private hoards absorbed 25% to 30% of the world's gold output.⁶ However, during the great depression she was transformed into a major exporter of the metal. Beginning with sterling going off the gold standard in September 1931, India exported gold worth nearly £250 million (net) over the next seven years. Contemporaries welcomed these outflows as the single-most powerful expansionary influence globally and, in particular, on the British economy.⁷ Although domestic deflationary policies had led her to ship gold for a brief period in 1920-22, the size and duration of Indian gold exports during the depression were unprecedented. Naturally, questions arise as to whether Britain sought to stimulate these exports as a way of easing her own crisis and, if yes, how she contrived to achieve this effect.

I

After a fashion, the issue has been examined earlier by B.R. Tomlinson and I.M. Drummond.⁸ But their treatment of the

⁵ For details of this argument see G. BALACHANDRAN, *Indian Monetary Policies and the International Liquidity Crisis during the Inter-War Years (1919-1939)*, unpublished Ph. D. thesis, University of London, 1989.

⁶ See J. Kitchin's statement of evidence to the *Committee on Finance and Industry* (Macmillan Committee), HMSO, London, 1931, para. 7.

⁷ PRO, T175/57, Part 2, Phillips's memoranda of 27 and 29 February and letter to Henderson, 26 February 1932; *Collected Writings of John Maynard Keynes*, Vol. XXI (JMK XXI), London, 1932, pp. 70-2 and Vol. IX (JMK IX), London, 1972, p. 353.

⁸ B.R. TOMLINSON, "Britain and the Indian Currency Crisis - 1930-32", *Economic History Review* (EHR), 1979; I.M. DRUMMOND, *The Floating Pound and the Sterling Area*, Cambridge, 1982.

subject is piece-meal and unsatisfactory. Locating Anglo-Indian financial relations exclusively in their bilateral dimension, they have tended to read the primary sources literally. Having scoured official records for direct evidence that Britain promoted Indian gold exports and not finding any, they conclude that solutions to her external problems were not sought at India's expense.

In the absence of a global macro-perspective, Tomlinson and Drummond assume away the hypothesis they wish to disprove. Also, by separating the depression years from earlier episodes, they fail to detect the underlying logic of the policies that authorities in London wished India to pursue during the inter-war years. The present essay argues that this logic, which came into its own in the depression, was determined by Britain's chronic liquidity crisis during these years and India's traditional counter-cyclical role in the international economy.

II

The most explicit recognition of India's counter-cyclical influence in the world economy is owed to Keynes, who stressed that India's enormous private absorption of gold made her a major anti-inflationary influence in the international economy.⁹ He warned that, should asset habits change, India would have the world's money markets "at her feet" and advised policy-makers to prepare for this eventuality. He also emphasized that India would release gold in a famine or a depression.

Policy makers in pre-1914 London were more exercised by the size of Indian gold imports than by the inflation that would be caused, were she to shed her stocks of the metal. Yet the belief prevailed that her positive net short-term position and the bank rate would enable London to manage these drains. Therefore, policy was predicated on the expectation that India's gold

⁹ JMK I (*Indian Currency and Finance*), London, 1971, p. 70.

imports would decline in the long-term as her financial markets deepened.

The First World War, which brought Britain's latent payments pressures to the fore, changed this rather indulgent attitude. Correcting her external imbalance was seen to be critical to realising Britain's longer-term aim of recasting the post-war international financial system in the image of the pre-war one. Had her policy-makers not foregone some options (devaluation, empire integration, etc.), Britain's adjustment to her external crisis might have been less problematic. With political and social factors constraining domestic adjustment options as well, Britain was forced to seek the resolution of her self-imposed dilemmas in an expansionary world economy. In the pre-1914 period she could be the "locomotive" that led global expansion. However, in the 1920s policy-makers realized that an autonomous British expansion (say by lowering discount rates) affected her balance of payments more than world prices. With strong current account positions, only the USA (and to an extent, France in the late 1920s) could now be expected to trigger and sustain global expansion.¹⁰

In the early inter-war years, Britain hoped to induce this expansion, as also augment her dollar earnings directly, by exporting gold to the USA.¹¹ This factor, among others, also created

¹⁰ CHURCHILL COLLEGE ARCHIVES (CCA), Hawtrey Papers 1/13, "The Rediscount Rate of the American Federal Reserve System", memorandum, n.d., S. HOWSON, *Domestic Monetary Management in Britain, 1919-1939*, Cambridge, 1975 and J. KOOKER, "French Financial Diplomacy: The Inter-War Years", in B. ROWLAND, ed., *Balance of Power or Hegemony: The Inter-War Monetary System*, New York, 1976, pp. 83-117.

¹¹ CCA, Hawtrey Papers 1/13, "Return to Gold Standard", memorandum of July 1920, "American Exchange", n.d. but July-August 1921, and 1/26, "Export of Gold to America", note of 3 March 1923; see also HOWSON, *Domestic Monetary Management...*, D.E. MOGGRIDGE, *The Return to Gold: The Formulation of Monetary Policy and its Critics*, Cambridge, 1969 and *British Monetary Policy, 1924-31: The Norman Conquest of \$ 4.86*, Cambridge, 1972. The primary sources in support of this view are also briefly examined in BALACHANDRAN, *Indian Monetary Policies...*, Chap. 4.

the need to divert a greater share of the world's gold output away from private reserves.

As previously stated, India was the largest absorber of gold on the private account. Her appetite for gold had to be checked if it was not to threaten the British effort to promote world expansion, but there was a catch. Gold being the dominant form in which the Indian house-holder held his savings, his demand for the metal depended on income. The higher the latter, *ceteris paribus*, the higher his demand for gold. Therefore, unlike in the US and French cases, where expansion would reduce gold absorption (i.e. current account surpluses), restricting India's demand for gold involved either deflating her economy or insulating her from global expansionary stimuli. Hence, successively depressive short-term macro-policy, rather than the longer-term aim of developing financial markets, now became the main instrument for securing a change in the asset-holding habits of the Indian householder.¹²

The literature on inter-war Britain's external economic problems, the choices made by her policy-makers, their effects on the domestic economy, etc. is voluminous.¹³ Yet, their implications for Britain's formal and informal empire, considered so significant by contemporaries, have been almost totally neglected by modern scholars.¹⁴ In other papers, I have applied the

¹² This summary is based on BALACHANDRAN, *Indian Monetary Policies...*

¹³ Apart from the studies cited above, also see the essays in S. POLLARD, ed. *The Gold Standard and Employment Policies between the Wars*, London, 1970 and D.E. MOGGRIDGE, "The Gold Standard and National Financial Policies, 1919-39", in P. MATHIAS and S. POLLARD, eds., *The Cambridge Economic History of Europe*, Vol. VIII: The Industrial Economies: The Development of Social and Economic Policies (*CEHE VIII*), Cambridge, 1989, pp. 250-314. For political-economic explanations of the choices made by British policy-makers, see G. INGHAM, *Capitalism Divided? The City and Industry in British Social Development*, London, 1984 and R.W.D. BOYCE, *British Capitalism at the Crossroads, 1919-1932: A Study in Politics, Economics and International Relations*, Cambridge, 1987.

¹⁴ For a contemporary view, see W.A. BROWN, *England and the New Gold Standard*, London, 1929.

above argument to earlier stabilization episodes in India.¹⁵ The rest of this essay examines the argument in the context of the depression.

III

Britain's external stability problems in the early years of the depression are too well known to require much discussion. The combination of trade, capital account and policy shocks emerging from USA (and to a lesser extent France) upset Britain's current account position further and unsettled the short-term markets. Outflows from London were serious enough to affect the Bank of England's gold reserve which fell from about £163 million in 1928 to less than £147 million in 1929 before rising in the wake of reserve liquidation by central banks on the periphery.¹⁶ It was a sign of the times that the somewhat absurd refrain of the "gold shortage school", on the fringes of the policy apparatus until 1928/29, came to be echoed by the Treasury.¹⁷

The immediate problem facing Britain in 1930 and 1931 was two-fold. The first was the well-known mis-match between her liquid and short-term liabilities and assets.¹⁸ The second prob-

¹⁵ G. BALACHANDRAN, *India in Britain's Liquidity Crisis: The Stabilization of 1920*, Occasional Papers, School of Oriental and African Studies, 1990, "The Sterling Crisis and the Managed Float Regime in India, 1921-1924", *Indian Economic and Social History Review (IESHR)*, No. 1, 1990, "Britain", *EPW*, August 1989 and *Indian Monetary*.

¹⁶ The Bank's ability to intervene in the gold market was also affected. In 1928 and 1929, it was able to buy about 50% of the gold sold in London, but in 1930, could buy only £ 1.41 million out of the £ 44 million sold. See *Report of the Committee on Finance and Industry* (Macmillan Committee, Report), HMSO, London, 1931, paras. 165-66. For an account of the crisis, see D. WILLIAMS, "London and the 1931 Financial Crisis", *EHR*, 1963, pp. 513-27.

¹⁷ According to its adherents, "mal-distribution" of gold was the chief source of Britain's problems. See PRO T170/46, "Gold Standard and Rationalization", n.d. but 1930 and T160/430, F. 12317/1, Hawtrey to Hopkins, letter of 10 December 1930. The Macmillan Committee also explained the depression in these terms. See Montagu Norman's testimony and *Report*, paras. 240, 185 and 140-150. Also see DRUMMOND, *Floating Pound*, pp. 128-33.

¹⁸ For discussions of the British liquidity position, see MACMILLAN COMMITTEE,

lem concerned the limitation of the bank rate as a policy instrument. Apart from growing domestic opposition to its use, a higher bank rate, rather than calling in Britain's short-term assets, only attracted hot money from abroad and worsened her net short-term position; so much so that British policy-makers felt powerless to affect this "scramble" for gold.¹⁹ This was the environment in which deflation in India became the means to finance a shift of liquid resources to the centre.

IV

The 1920s, as some officials realised, had been a period of almost continuous deflation in India and whatever expansion the rest of the world saw, had bypassed her.²⁰ In 1928, briefly it seemed as if, with the recently-revalued rupee almost stable and the terms of trade returning to the 1913 level, the clouds over the Indian economy were beginning to clear. But this breathing space was the attenuated form in which contractionary domestic policies delivered that year's global expansion in India. The slump that began soon after was to affect her more dramatically.

Expectedly, the Indian trade account was the first to be affected. Given the rather small size of the trading sector in her

Report, paras. 351-52, ROBERT TRIFFIN, *Gold and the Dollar Crisis*, Princeton, 1960, A. CAIRNCROSS and B.J. EICHENGREEN, *Sterling in Decline: The Devaluations of 1931, 1949 and 1967*, Oxford, 1983 and B.J. EICHENGREEN in W. BUITER, and R. MARSTON, eds., *International Policy Coordination in Historical Perspective*, Oxford, 1985.

¹⁹ MACMILLAN COMMITTEE, *Report*, para. 351. The Treasury was not insensitive to domestic opposition to using the bank rate. See PRO T160/430 F. 1317/2, "Gold Movements: Points for Discussion with the French Treasury", memorandum by Leith-Ross, 12 February 1931 and CCA Hawtrey Papers 1/47, "Bank Rate and the Crisis", memorandum, 1 August 1931.

²⁰ PRO T160/519, F. 12471/05/4, "Reserve Bank of India: Notes on Reserves and Currency Policy", memorandum by George Schuster, Finance Member in the Government of India. At the Treasury, Hawtrey identified two deflationary phases. 1920-23 was "heavily" and 1923-29 was "moderately" deflationary due to rupee appreciation - "Indian Balance of Payments", memorandum, 9 August 1933; also D.H. ALDCROFT, *From Versailles to Wall Street, 1919-1929*, London, 1977, p. 216.

economy, the impact should have been easily contained. The excessive influence of trade financing upon monetary expansion together with fixed debt obligations ensured, however, that policy would be pro-cyclical.²¹ The official commitment to free short-term capital flows had the same effect.

The effects of the depression on Indian trade are well-known and it is not proposed to discuss it at any length in the text.²² Tables 1 and 2 show the decline in trading values and the terms of trade respectively. Together, they also tell the story of trading volumes in these years. The only point that needs to be stressed here is that the instability of the Indian trade account pre-dated the depression.

Neither did the current account (Table 1) worsen alarmingly even in the early years. The 1929/30 deficit was about 3% of non-gold exports and lower than the corresponding proportion for 1928/29. The 1930/31 proportion of about 10%, though no higher than that in 1927/28 and lower than for 1926/27 (15%), was perhaps unsustainable but did not indicate panic measures.

The most serious changes were on the capital account (Table 3). With long-term capital inflows declining, by 1928/29 short-term inflows financed almost the entire current account deficit. From 1929/30, volatile short-term funds became the major source of weakness in the Indian balance of payments. A net short-term capital inflow of Rs. 178 million in 1928/29 became a net outflow of Rs. 33 million in 1929/30, increasing to Rs. 181 million in 1930/31 and Rs. 393 million in 1931/32.

A major feature of the depression was the large exports of gold that took place from India after September 1931 (Table 1). Gold imports had already declined in the first two years of the

²¹ DHARMA KUMAR, "Fiscal System" in DHARMA KUMAR and M. DESAI, eds., *Cambridge Economic History of India*, Vol. 2 (CEHI II), Cambridge, 1982, p. 942. For a description of the Indian currency system, see A.G. CHANDAVARKAR, "Money and Credit", CEHI II, pp. 903-44.

²² For a survey of the trends, see K.N. CHAUDHURI, "Foreign Trade and Balance of Payments", CEHI II, pp. 804-77.

Table 1
INDIAN CURRENT ACCOUNT: 1926/27 - 1937/38

Year	1	2	3	4	5	6
26/27	3320	2969	-194	-298	-347	-488
27/28	3529	3016	-181	-314	-347	-329
28/29	3663	2998	-325	-312	-212	-183
29/30	3404	2867	-316	-180	-142	-100
30/31	2442	2071	-336	-159	-128	-251
31/32	1740	1518	-348	-179	580	275
32/33	1460	1515	-344	-162	655	95
33/34	1635	1364	-339	-122	571	380
34/35	1707	1594	-325	-139	525	174
35/36	1821	1628	-320	-160	374	88
36/37	2175	1608	-324	-183	278	338
37/38	2050	2050	-302	-181	163	-320

All figures are rounded off to the nearest Rs. million.

1. Non-treasure commodity exports; 2. Non-treasure commodity imports; 3. Interest and dividend flows; 4. Other service items; 5. Gold flows; 6. Total current account surplus (+) or deficit (-).

Source: "Government of India's Estimates of India's Balance of Payments during 1923-24 to 1938-39 as submitted to the League of Nations", Table XLVII in A.K. BANERJI, *India's Balance of Payments: Estimates of Current and Capital Accounts from 1921-22 to 1938-39*, London, 1963, pp. 236-37.

Table 2
TERMS OF TRADE: 1927-1936

Year	Export price	Import price	Terms of Trade
1927/28	100.0	100.0	100.0
1928/29	97.5	96.4	100.1
1929/30	90.2	93.2	96.1
1930/31	71.5	80.0	89.4
1931/32	59.2	71.7	82.6
1932/33	55.3	65.2	84.8
1933/34	53.5	63.5	84.3
1934/35	54.1	63.0	85.9
1935/36	56.9	62.1	91.6
1936/37	57.2	62.8	91.0

Source: *Annual Review of the Trade of India*, in CHAUDHURI, *CEHI II*, p. 840.

Table 3
THE INDIAN CAPITAL ACCOUNT:
1926/27 - 1937/38

Year	1	2	3	4	5
26/27	476	92	107	3	488
27/28	182	35	248	66	329
28/29	145	140	179	—	184
29/30	204	71	41	74	100
30/31	484	52	—	181	251
31/32	358	240	—	393	-275
32/33	128	193	52	82	-95
33/34	254	469	—	96	-312
34/35	37	124	—	106	-192
35/36	n.a.	n.a.	n.a.	n.a.	-121
36/37	n.a.	n.a.	n.a.	n.a.	-333
37/38	n.a.	n.a.	n.a.	n.a.	53

All figures are rounded off to the nearest Rs. million.

1. Long-term capital inflows; 2. Long-term capital outflows; 3. Short-term capital inflows; 4. Short-term capital outflows; 5. Net capital flows [(—) indicates net outflows].

Source: BANERJI, *India's Balance*, pp. 236-37.

depression (1929/30 and 1930/31). From the next year and until 1937/38, India emerged as a net exporter of gold. Together with the surplus on the merchandise account (or even after being offset by a small deficit in 1932/33) gold exports meant that India, with a current account surplus, discharged a part of her foreign debt or even lent abroad. Gold exports lasted till 1938/1939 and current account surpluses till 1936/37. It is worth noting that even without gold exports, India's trade balance would have been positive during much of this period and she could have borrowed to finance a current account deficit, had such finance been available. Given the conditions of the world economy and the British external liquidity position, Indian gold exports functioned in effect as a useful variable. For a period during the depression, contemporaries saw them as the major ex-

pansionary influence on the world economy and the most important source of support for the sterling.²³

V

Scholars familiar with the period would recognise that the main problem facing Indian authorities from the winter of 1929 to the autumn of 1931, i.e. the outflow of short-term capital, had its origins outside India and was not peculiar to her.²⁴ But officials attributed it to popular agitation in India.²⁵

It is likely that (apart from depressed trading conditions) short-term outflows from India reflected the desire to withdraw funds from the sterling area. Sterling was strong against the rupee but as it weakened against the dollar and the franc, the tendency to flee the sterling area would have also affected rupee holders. This was the view held by Osborne Smith, the General Manager of the Imperial Bank of India.²⁶ The small amounts of

²³ See note 7 above. Yet they do not seem to have stimulated much domestic expansion. Also see D. ROTHERMUND, "British Trade Policy in India during the Great Depression", *IESHR*, 1981, pp. 349-376, and C.J. BAKER, *An Indian Rural Economy, 1880-1955: The Tamilnad Countryside*, New Delhi, 1984. Estimates of national income are in A. HESTON, "National Income", *CEHI II*, pp. 376-452 and R. GOLD-SMITH, *Financial Development of India, 1860-1977*, Delhi, 1983, p. 69.

²⁴ Moggridge, *CEHE VIII*, p. 313. For other country studies, see R. THORP, ed., *Latin America in the 1930s: The Role of the Periphery in the World Crisis*, London, 1984, DIAZ-ALEJANDRO, "Latin America in Depression, 1929-39" in M. GERSOVITZ et al, eds., *The Theory and Experience of Economic Development: Essays in Honour of Sir William Arthur Lewis*, London, 1982, pp. 334-55 and A. FISHLOW, "Lessons from the Past: Capital Markets during the 19th Century and the Inter-War Period", in M. KAHLER, ed., *The Politics of International Debt*, Ithaca, 1986, pp. 37-93.

²⁵ INDIA OFFICE LIBRARY AND RECORDS (IOLR) L/F/7/474, F. 22, Colln. 43, Viceroy to Secretary of State, telegram, 9 & 10 May 1931. The official view is unsatisfactory for several reasons but they need not detain us here. The Indian government sought a stand-by credit from London but was turned down. The relevant files - PRO T160/400 F. 12471/03/1-2 and IOLR L/F/6/1177 F. 3693, are discussed in Tomlinson, *EHR*, 1979 and DRUMMOND, *Floating Pound*. Another reason for the phenomenon (again neither peculiar to India nor endogenous) was that funds no longer needed to finance her reduced exports were being repatriated; see IOLR L/F/5/189, S.F. Stewart to Lord Chancellor, 21 August 1931, para 5.

²⁶ For most practical purposes, the Imperial Bank was India's central bank. Nehru Memorial Museum and Library (NMMA) Purushottamdas Thakurdas (PT) Papers,

gold that India exported in January 1931 bypassing London and going directly to Paris also supports this view. By August 1931, it was clear that even British firms were leaving sterling for "dollars, francs and guilders".²⁷ Short-term fund outflows from India had also resumed and the Imperial Bank confirmed that London was the main source of weakness for the rupee.²⁸

As capital outflows grew, the Indian monetary authorities could have imposed restrictions on them as some Latin American countries did.²⁹ There is no evidence of the Indian government proposing or of the India Office considering the measure before September 1931.

This yields an insight into the priorities of the Indian government and its superiors in London: other objectives were subordinated to those of servicing official sterling obligations and repatriating short-term balances. In fact, India's ability to meet her external obligations and the state of the market for rupees were the only criteria that Whitehall officials used to measure India's "recovery" in the depression.³⁰ Monetary and fiscal policies were oriented towards the former and towards adjusting the economy to short-term outflows.

The factors underlying London's priorities in relation to India have already been anticipated. At a time of weakness in her current account position, the importance of transfers from India for the British balance of payments could hardly be exaggerated.³¹ Besides, with Britain's net short-term position unravelling and capital markets turning more volatile, an Indian

File 105, Osborne Smith to Purushottamdas Thakurdās, letter, 20 November 1930. A run on Indian reserves due to an attack on sterling had been foreseen in 1925; CCA Hawtrey Papers, 1/3/2, Hawtrey to Blackett, letter, 16 October 1925.

²⁷ PRO PREM 1/97, Reading to Prime Minister, letter, 10 September 1931 and Boyce, *British Capitalism*, p. 340.

²⁸ IOLR L/F/6/1180, F. 606, Viceroy to Secretary of State, telegram, 16 September 1931.

²⁹ Note 24 above.

³⁰ See for example PRO T177/12, Phillips to Hopkins, note, 20 July 1934.

³¹ PRO T172/1756, "The Balance of Payments", n.d. but summer of 1931.

embargo would have sent signals to sterling-holders that would have been little short of catastrophic. Equally perhaps, as controls eased further deflation, the logic of British policy in inter-war India (discussed above) would have been defeated.

With controls ruled out, the authorities could either borrow abroad to augment reserves or enforce contraction in India.³² But as prospects of borrowing in London appeared slim, the pressure to adopt the latter policy grew; at regular intervals the Bank of England pressed contraction upon the India Office.³³ The Paper Currency Reserve (PCR), which represented the biggest component of high-powered money, fell from Rs. 1867 million in September 1929 to Rs. 1487 million in the next two years (Table 4).³⁴ By November 1930, the Imperial Bank of India was finding Whitehall's demands for contraction, unsustainable.³⁵ With increases in the Treasury bill rate, the weighted average of the Indian bank rate in 1930 and 1931 was about 7% (with a high of 8% and a low of 5%) while that of the bank rate in London was under 4 per cent.³⁶

³² London's rejection of the third option (devaluation) is an interesting story, but tedious to recount here. To oppose the idea (which was gaining local support) the India Office used a model of a fully monetized economy with a wage-bargaining process in which farm labourers (paid in cash) aimed to protect their real wages! IOLR L/F/6/1183 F. 6619, Meeting on Financial Questions, 16 October 1931; L/F/5/189, "The Exchange Question" by Kisch, 24 November 1930 and Stewart's letter to the Lord Chancellor, 21 August 1931; L/F/6/1183 F. 6444, note by Hoare, 30 August 1931 and Kisch's "The Effect on the Indian Economy and Credit of a Collapse of the Rupee Exchange", 18 September 1931; The India Office's contradictory postures on the depression and on how recovery should proceed are discussed in BALACHANDRAN, *Indian Monetary Policies...* Chap. 6.

³³ IOLR L/F/6/1175 F. 2222, Secretary of State to Viceroy, telegram, 18 April 1931. The Governor wanted "money famine to frighten bears of exchange..." L/F/6/1177, F. 3693, Norman to Kisch, letter, 5 May 1931.

³⁴ The currency in circulation was fully backed by gold, silver, investments in sterling paper and government securities in the Paper Currency Reserve.

³⁵ NMMA PT Papers, Osborne Smith to P. Thakurdas, letter, 27 November 1930.

³⁶ IOLR L/F/5/101-102, Financial Department Statistics, p. 73 and p. 21. The depression was also affecting government finances. See *East India Finance and Accounts*, HMSO, London, various years. The budget files are IOLR L/F/6 - 1180 F. 5952, 1173 F. 392, 1174 F. 2134 and 1188 F. 462; for a discussion, see my *Indian Monetary Policies...* Chap. 6.

Table 4
GROSS COIN AND NOTE CIRCULATION:
QUARTERLY, 1929 - 1934

Year	March	June	September	December
1929		1877	1867	1794
1930	1772	1637	1715	1613
1931	1608	1525	1487	1793
1932	1781	1708	1757	1748
1933	1769	1765	1797	1781
1934	1772	1808	1851	1839

All figures are in nearest Rs. million.

Source: Government of India, *Reports of the Controller of Currency*, different years.

VI

Exchange Intervention and Official Gold Exports

The depression and the government's pro-cyclical policy forced the liquidation of the Indian cultivators' most marketable asset (gold) to settle debts or finance consumption.³⁷ Before the rupee followed sterling off the gold standard in September 1931, the bulk of this gold accumulated in the Indian portion of the exchange reserve (gold standard reserve or GSR), which had already been swollen by the "transfer" of a portion of the London reserves to India.³⁸ As the Indian cultivator liquidated his

³⁷ By January 1931, some 1600 ounces of gold "mostly in the form of jewellery" was arriving daily in Bombay; IOLR L/F/6/1172 F. 37, P&O Banking Corp. to Kisch, letter, 1 January 1931. The monthly receipts of the Bombay mint alone between January and September 1931 amounted to more than £ 1 million. See Viceroy to Secretary of State, telegrams of 1 April 1931 in L/F/6/1175, F. 2222, 24 April in L/F/7/474 F. 22, Colln. 43 and 20 January 1932 in L/F/6/1188 and GEORGE SCHUSTER, *Private Work and Public Causes: A Personal Record, 1881 - 1978*, Cambridge, 1979, p. 115.

³⁸ This "transfer" happened because reserve losses from intervention in London were offset by contracting the PCR in India; the reserves so released were credited to the Indian component of the GSR. Thus, intervention led to the shuffling of the exchange reserves between London and India, while depletion was engineered in the PCR.

gold holdings and replenished the exchange reserves in India, reserve depletion in London would not matter as long as the former could be made available there to defend the rupee; neither would the limit to exchange intervention imposed by reserve depletion apply as strongly. Thus, although the "normal" size of the exchange reserve was £40 million (of which, by September 1931, only £12.8 million was in London and the rest was in the form of gold in the Indian portion of the exchange reserve), this no longer constituted an effective limit to intervention.³⁹

As reserves declined in London and rose in India, Whitehall began to demand that the Indian government ship gold to replenish them. The earliest India Office demand came in spring 1931.⁴⁰ But pressure eased when the Governor of the Bank of England advised postponement of Indian gold sales till the autumn.⁴¹

April and May were periods of relative ease for the Bank. However by the end of June 1931, the strain of resumed French withdrawals began to be felt and the drain on the Bank's reserves revived. The India Office reopened the gold question, which had only recently been put away till the autumn, but again failed to overcome Delhi's resistance.⁴²

³⁹ The reserve composition figures are from Government of India, Report of the Controller of Currency, relevant years and IOLR L/F/6/1177 F. 3693, minute by Kisch, 4 August 1931.

⁴⁰ IOLR L/F/7/474 F. 22, Colln. 43, Viceroy to Secretary of State, telegram, 24 April 1931; reply, 28 April 1931; L/F/6/1175 F. 2222, "Notes on Viceroy's telegram of 24 April 1931" and minute by Kisch, 4 May 1931. Thanks to DRUMMOND, *Floating Pound* and TOMLINSON, *EHR*, 1979, we can avoid quoting the evidence at length.

⁴¹ IOLR L/F/7/474 F. 22 Colln. 43, Secretary of State to Viceroy, telegram, 6 May 1931. Norman's intervention raises intriguing questions. He claimed that India might need to export gold in the autumn. But autumn drains were a London phenomenon while India usually faced an inflow at this time as her "busy season" got under way. Unless the weakness of the sterling caused the rupee's crisis, outflows from India would (at least) slow down in the autumn. More likely, with London's plight easing in May, the Governor might have liked to keep Indian gold in reserve for the resumption of drains in the autumn.

⁴² IOLR L/F/6/1178 F. 4247, Secretary of State to Viceroy, telegram, 30 June 1931 and L/F/7/474 F. 22, Colln. 43, Viceroy to Secretary of State, telegram, 13 July 1931.

Facing severe reserve drains at the end of August 1931, the India Office returned to the subject.⁴³ From early September, the Indian authorities planned to ship sovereigns but, in order to stem domestic criticism, proposed their simultaneous sale in India at a better price.⁴⁴ The India Office rejected the idea on the ground that it would increase domestic gold consumption in India!⁴⁵ Soon after this, the closure of the gold window in London briefly relieved New Delhi from pressures to export gold on the official account.

Tomlinson and Drummond cite the absence of any reference to Britain's external position in these exchanges to refute the view that Indian gold was sought to bolster it. Certainly, apart from fear of the effects of an Indian default on the London market, there is no direct evidence that Britain's liquidity crisis motivated Whitehall to seek official gold exports in this period. Yet, there can be no doubt that Treasury and India Office bureaucrats were aware of the benefits for London of such exports from India. Could it be that Britain's liquidity problems were too obvious to mention in internal Whitehall notes, while being too controversial to mention in communications with New Delhi? Is there indirect evidence to show that the periodic demands that London made for gold from India might have been motivated by its own needs?

Firstly, it is interesting to note that the stridency of the India Office demand for gold seems to have coincided with the severity of the drains faced by London.⁴⁶ Secondly, consider the India Office view that gold sovereigns should be shipped to London and not sold in India. As in 1920, when the government in-

⁴³ A stiff telegram demanded "immediate" shipment of £ 6.5 million in gold. IOLR L/F/7/474 F. 22, Colln. 43, Baxter's minute, 26 August 1931 and Secretary of State to Viceroy, telegram, 28 August 1931 and reply, 31 August 1931.

⁴⁴ Rs. 13-5as to Rs. 13-10as in India vs. Rs. 13-4as in London, with the Indian government meeting the freight, insurance charges and the commissions.

⁴⁵ IOLR L/F/7/474 F. 22, Colln. 43 telegrams of 10 and 17 September.

⁴⁶ Of course, this could be partly explained by the two drains (i.e., on London and India) coinciding.

tervened in the Indian gold market to check domestic prices (as well as the price of the metal itself), gold sales would have had a contractionary effect similar to open market operations; also perhaps they would have stimulated gold exports.⁴⁷ However, at this time (i.e. before sterling left gold), private Indian gold exports might not have been as useful for London as official gold exports.⁴⁸

Further, the Finance Department of the India Office was closely connected to the City and the Treasury. Its officials knew and accepted the Whitehall view that the depression was caused by a "mal-distribution" of gold and that an international agreement on liquidity was needed to ease Britain's crisis. For example, the official British plan for the redistribution of liquidity (the "Kisch Plan") was formulated in 1932/33 by an India Office Finance Department official (Cecil Kisch) who was also the most vocal advocate of a deflationary Indian response to the crisis.⁴⁹ The surprise is not that officials at the India Office were familiar with the official British view of the depression. Rather, the surprise is that there are so few references to it in the records that the omission seems almost certainly self-conscious.

Besides, the process and the seemingly spontaneous manner whereby gold sales by the Indian private sector made up for reserve losses in intervention invites comparison with the 1920 stabilization episode. Apart from providing a wider perspective to our argument, the comparison would enable us to address the question that we have raised above regarding "silences" in the official records.

⁴⁷ See BALACHANDRAN, *Indian Monetary Policies...* Chap. 3 and *India*.

⁴⁸ Given a weak sterling, gold would have been shipped directly to Paris or New York and would not have been available to meet drains on London. Note that Indian gold exports that took place in December 1930 went to Paris and the India Office was keen to know why this had happened; IOLR L/F/6/1172 F. 37, P&O Banking Corporation to Kisch, letter, 1 January 1931, Kisch to Mocatta, letter, 2 January 1931 and reply, 3 January 1931.

⁴⁹ For an account of the plan see DRUMMOND, *Floating Pound*, p. 139. For a flavour of Kisch's views on Indian policy, see his "Note of Qualification" in IOLR L/F/6/1180 F. 5952, Secretary of State to Viceroy, telegram, 17 September, 1931.

As discussed elsewhere, in 1919/20 her large sterling reserves (representing export surpluses of the war years) had to be "sent" to India in the form of private or official gold or silver transfers to preserve the stability of the currency system.⁵⁰ However, the India Office, fearing for Britain's already severe external disequilibrium, proposed a hefty revaluation of the rupee as part of a deflationary package whose explicit aims were to (a) reduce the private demand for gold, (b) reduce note circulation and thus increase its metallic backing and (c) force the Indian householder to liquidate his metallic assets so that the currency reserves would be replenished from these hoards rather than through imports.⁵¹

Although the circumstances in India and in the rest of the world were quite different during the two periods, a process similar to the above was at work even in 1930/31. Britain again faced a liquidity crisis and the onus of adjustment once more fell on Indian households. Whereas in expansionary 1920 counter-cyclical policies were deployed to depress the latter's incomes and check their appetite for gold, in depressed 1930/31 procyclical and deflationary domestic policies ensured that they would be forced to liquidate their assets to finance consumption or settle debts in the face of falling incomes. In the process, Indian householders again financed a transfer of liquid resources to Britain.

In 1920, what I would like to call the "mirror-image deflation model" of the India Office was still new and untried. But,

⁵⁰ The instability of the currency system between 1917 and 1920 arose because Indian currency notes were "convertible" into (more popular but also token) silver rupees. However, purchase of silver for coinage lagged greatly behind the expansion of note issue in these years. The "convertibility" problem that resulted was compounded by war-time checks on imports of gold. For a detailed discussion, see BALACHANDRAN, *Indian Monetary Policies...* Chaps. 2 and 3 and *India*.

⁵¹ TOMLINSON, in a reformulation of his earlier position, accepts that Indian monetary and currency policies in 1920 were British-centred but considers it an exception. See his *Political Economy*, and "Comment", in my *India*. But as this essay shows, in the depression also British priorities dominated policy-making.

applied at least twice during the decade, the model had been well worked out by the time the depression came to India. For this reason alone, if for no other, the evidence to support the view that deflation in India was engineered or was not arrested in order to ease the British crisis would be less explicit. Yet, consider that India's external position in 1919/20 and 1930/31 could not have been more different. In the latter year, reserves were being depleted in London while they were accumulating in India. The logical policy now, in terms of the counter-cyclical course adopted in 1919/20, would have been to devalue the rupee so that India's trade position improved, capital flows reversed direction and monetary expansion reduced official metallic reserves in India. However, like the strengthening of the Indian currency system in 1919/20 through metal imports, this policy too would not have suited the British interest. A 1930 devaluation, while reducing reserve losses in intervention, might not have been expansionary in the above manner.⁵² Regardless, a comparison of the two episodes shows that Britain was forcing similar (deflationary, and so anti-cyclical in a boom and pro-cyclical in a slump) policies on India to "tackle" two dissimilar situations. Only her liquidity crisis in both these periods and her consequent desire to determine the direction of gold flows can explain this seeming paradox.

In the background of this brief comparison it is possible to further penetrate the "silences" in the official records. Even during the depression years, policy-makers in London used a model in which, in the short and medium term, changes in the real exchange rate checked expansion or caused/sustained deflation in

⁵² Equally, it might have made Indian gold exports more profitable. Yet, it is moot whether, with a rise in domestic incomes and in the prices of her commodity imports and their domestic substitutes, gold release in India would have been sustained at pre-devaluation levels. The India Office itself believed in 1920 that the negative (positive) income effect of a revaluation (devaluation) on Indian asset appetites would swamp the positive (negative) asset-price effect especially as the latter would also be affected by a fall in the prices of commodity importables. See IOLR L/F/7/612 Qns. 340-47. There is no reason to suppose that this belief had changed by 1930.

India and affected her appetite for gold. Combine the implicit role that gold imports played in the India Office's model (since Keynes first drew attention to it) with the official British "gold shortage" explanation for the depression, with which, as we have already seen, India Office bureaucrats were quite familiar. Then two points emerge. Firstly, it is highly unlikely that the latter were unaware that London would benefit from Indian gold exports (official or unofficial). Secondly, Britain's crisis may have affected India Office's macro-policy in the depression in more ways than a literal reading of the primary sources would reveal.⁵³

VII

Private Gold Exports and Sterling Policy

Britain's abandonment of the gold standard in September 1931 caught the Government of India by surprise.⁵⁴ Whilst awaiting news from London, the Indian government announced comprehensive controls on capital outflows. Whitehall's inclination, curiously (but not inexplicably) contrary to policy adopted

⁵³ Events after September 1931 also support a London-centred view of the policy response to the depression in India. By October remittances to India had revived. But London continued to insist on official gold exports; PRO T160/474 F. 12471/06/1, Leith-Ross's note to Hopkins (November 1931) said Schuster's attitude to gold exports was "unsatisfactory" and "we must get him to part with about £ 5 million at least". London's initial justification (capital gains on gold sales) was shot down by Delhi and gave way to another (revenue losses from holding gold). The quality of the investment advice that Delhi received from London can be judged by the fact that even in 1933, when the Treasury, fearing competitive depreciation, was reducing its EEA dollar holdings and moving into gold (Table 5 below), the India Office held that there was a smaller risk in holding sterling than in holding gold; see IOLR L/F/6/1201, F. 1623, Secretary of State to Viceroy, telegram, 15 March 1933. Also see IOLR L/F/6/1175 F. 2222, and L/F/7/474 F. 22 Colln. 43.

⁵⁴ Acting unilaterally, London pegged the rupee to sterling at the existing parity. The relevant exchanges are in IOLR L/F/7/474 F. 22 Colln. 43, L/F/6/1181 F. 6195 and L/F/6/1180 F. 6060. See TOMLINSON, *EHR*, 1979, pp. 88-106 and DRUMMOND, *Floating Pound*, pp. 41-43 for details. GEORGE SCHUSTER, *Private Work...* pp. 112-15 believed news was delayed to present him with a *fait accompli*.

in Britain, was to keep India free of controls.⁵⁵ With checks already in place, it could seek only to replace them with milder controls on capital flows.⁵⁶

The most important outcome of sterling depreciation, for our purposes, was the stimulus that it provided to private exports of gold from India. While there can be no doubt that the premium on gold (due to a lower gold-sterling parity) stimulated its export, there was another part to this process that should not be lost sight of. Even before sterling left the gold standard, large quantities of the metal had been coming into Indian currency offices; these gold arrivals had been the subject of the exchanges discussed in the previous section and could only have been distress sales. As the recovery in Indian prices did not begin till 1934/35, there is no reason to believe that distress sales ceased after September 1931, though possibly, a peasant selling his gold to the trader or the *shroff* got higher prices now.⁵⁷ Whitehall and New Delhi believed that profits motivated gold sales and did not consider that destitution may also have been at work.⁵⁸

Doubtless, some dishoarding of gold would have taken place, whatever the domestic policies adopted. But the absence of measures to mitigate the depression's impact on producers' incomes ensured a constant outflow of gold from hoards. Official purchase of the metal at market prices (as many Indian economists proposed) would have reduced dishoarding and made exports discretionary. In the event, the gold releases of the depression years were the logical sequel to a policy that had been designed to avert Indian gold demands in the relatively "expan-

⁵⁵ IOLR L/F/6/1181 F. 6195, Secretary of State to Viceroy, telegram, 20 September 1931.

⁵⁶ IOLR L/F/6/1180, note by Kershaw, 22 September 1931.

⁵⁷ ROTHERMUND has stressed that the premium induced Indian money-lenders to tour the countryside and collect their debts in gold; *An Economic History*, pp. 104-05.

⁵⁸ See Stewart's views in CCA Grigg Papers 2/20, letter to Grigg, 19 October 1934. Whitehall claimed to have wrought a "miracle" in the asset habits of the "East".

sionary" global conditions of the 1920s. When the world went into a slump in the 1930s, she became an exporter of gold, and an expansionary influence on the world economy.⁵⁹ Thus, India fulfilled Keynes' prescription of her role in the international system and his prophecy.

To those in London entrusted with the charge of Indian finances, these exports were especially welcome. The rupee was easily stabilized and by late October 1931, remittances revived. In January 1932, the India Office was confident enough about these receipts to discharge a £ 15 million loan that fell due during the month.⁶⁰

Almost immediately after they began, Indian gold exports were also seen to assist the British balance of payments and the management of sterling.⁶¹ Not surprisingly, therefore, policy-makers in Britain wanted to see them continue without interruption. For example, in January 1932, New Delhi felt that capital controls could be safely withdrawn in India. But the

⁵⁹ In 1931/32, Indian gold exports (about £ 45 million) almost matched South Africa's. They equalled 85% of South Africa's growing exports by value in 1932/33, 70% in 1933/34, 64% in 1934/35, 38% in 1935/36, 25% in 1936/37 and 16% in 1937/38. South Africa contributed about 60% of the world's gold output. Set against her earlier imports of 15% to 30% of the world's gold output, even the outflows of the last two years are remarkable. Indian figures are from the same source as Table 1. South African figures are from L. KATZEN, *Gold and the South African Economy*, Amsterdam 1964, pp. 18-19, 40-41 and 60-61.

⁶⁰ These developments caused great jubilation. Viceroy Willingdon exulted that for the "first time in... history owing to the economic situation, Indians are disgorging gold... We have sent... to London in the past 2 or 3 months... 25,000,000 sterling and I hope the process will continue...!" Cambridge University, Baldwin 105, letter to Baldwin, 17 January 1932. In a self-congratulatory note, the Secretary of State claimed credit for "tacking" the rupee to the sterling and causing gold exports. The Cabinet congratulated him for his "accomplish(ment)"; PRO T160/400 F. 12471 Annex. 7, "The Repayment of an Indian Loan: An Incident in the History of Whitehall Control", C.P. 23(32) of 15 January 1932 and Cabinet resolution of 20 January 1932.

⁶¹ In January 1932 they had enabled Britain to repay a large part of the stabilization credits raised in Paris and New York. The *Economist* (30 January 1932) said, "...a factor of prime importance... is ...India's gold shipments... (which) have helped... us to repay our debts to Paris and New York". Indian gold had also enabled the Bank of England to arrest a flight from the dollar in October 1931. See the *Investors' Chronicle*, 30 January 1932.

Treasury, an early opponent of all controls in India, made a *volte-face* and objected because it "may diminish the export of gold which is at present the only legal method of exporting capital from India. The export of gold has been very useful for sterling".⁶²

January 1932 saw the beginning of a nationalist agitation in India against gold exports. Fears in the City about its effects were echoed by politicians. Prime Minister Ramsay Macdonald was moved enough to write to the Secretary of State for India, Samuel Hoare. Quoting a "city friend" he said, "...at present exchange rates large amounts of gold would be shipped were it not for the picketing ...I do not know if you can do anything about this". Hoare replied with the Indian view that gold exports would not be affected. Authorities in Delhi and Bombay would ensure this, he assured Macdonald.⁶³

The need to sustain Indian gold exports was also a major objective influencing the management of the floating sterling. The availability of gold from India, in turn, enabled smoother management of the currency in an environment that was soon to be characterized by competitive depreciation.

The most important device for managing sterling was the Exchange Equalization Account (EEA). By December 1931, the Treasury was privately ruling out a large increase in the sterling parity of about \$ 3.40 unless world prices rose.⁶⁴ By February 1932, it was feeling more confident in the view that, rather than letting speculative short-term inflows push up sterling, the Bank of England should rapidly reduce the bank rate and continue to

⁶² PRO T160/400 F. 12471, Annex 7, Robinson's note, 21 September 1931 and F. 12471/06/2, Waley's minute and Leith-Ross to Kershaw, letter, both dated 22 January 1932. The India Office assured the Treasury that gold exports would not be affected by the proposed move. "We have no reason to think that the flow of gold is drying up". PRO T160/474 F. 12471/06/2, Kisch to Leith-Ross, letter, 25 January 1932.

⁶³ IOLR L/F/6/1188 F. 334, Macdonald to Hoare, letter, 19 January 1932 and reply of 22 January 1932.

⁶⁴ PRO T175/57, Hopkins, "Note on Mr. Keynes' memorandum of 16 November", 16 December 1931.

purchase gold. If lower bank rates, easier credit and exchange intervention "do not cure the inflow it will be necessary to let the pound respond in some degree. But I should keep any rise slow...", an official noted.⁶⁵ The EEA was set up to manage sterling with the aim of "keep(ing) down the pound".⁶⁶ Enabling intervention in the gold and foreign exchange markets, the EEA allowed Britain to insulate her economy from speculative capital flows and preserve the "cheap money" conditions considered necessary for domestic recovery.

Indian gold exports played a significant part in enabling the EEA to operate. Drummond argues that more than India's exports, the "eccentric strength of Britain's capital account" allowed gold accumulation in the account.⁶⁷ But there was no evidence, yet, of the future strength of the British capital account which, in 1932, continued to be subject to unpredictable outflows. Till it improved, British authorities were unable to buy gold or foreign exchange without weakening sterling more than they desired to, and here Indian gold exports came in handy.

For example, in February 1932, the Bank of England managed to avoid a fall in sterling while it bought dollars and francs because (among other reasons) gold flows from India, which accounted for two-thirds of Britain's total receipts of the metal during the month, tended to support sterling. With "...any diminution in supply (of gold) ...it would be by no means so easy to continue heavy ...purchases..." of foreign exchange. "Our store of gold is low ...(and if we) should fail to purchase sufficient exchange (needed to repay loans and steady sterling in

⁶⁵ PRO T175/57, memorandum by Phillips, 5 March 1932.

⁶⁶ "We cannot however put it quite as bluntly as that..." PRO T175/57, "Exchange Equalization Account Proposals", Hopkins's note, 6 April 1932 (emphasis in the original). Also S. HOWSON, "The Management of the Sterling, 1932-1939", *Journal of Economic History*, 1979, and *Sterling's Managed Float: The Operations of the Exchange Equalization Account, 1932-39*, Princeton, 1980.

⁶⁷ *Floating Pound*, pp. 50-51.

the autumn - G.B.) it would be necessary to draw further on our gold reserves".⁶⁸

Continued gold arrivals from India, however, sustained sterling through the autumn drains. Falling reserves and low interest rates caused a greater weakening of sterling than the British authorities wished to see. But "...Indian gold still... comes in at a substantial rate. We continue to get the advantage of it, and it is a material help at this difficult season of the year".⁶⁹

Britain's capital account no doubt improved after 1933. Yet the importance of gold receipts from India for the management of the EEA did not diminish. In the spring, the Treasury, expecting widespread currency instability, began reducing exchange holdings in the account. As Table 5 below shows, the additions to the account thereafter were entirely in the form of gold. Had gold from India not been available, Britain would have been much more vulnerable to competitive American depreciation and the EEA would have lost its teeth. Thus, regardless of the strength of her capital account, sterling management continued to depend on greater gold availability.

Therefore, it is not surprising that the need to promote Indian gold exports was an important factor determining the sterling parity. "The most desired objective is a general rise in world ...prices and... the most single powerful force to that end at the moment is the flow of gold from India. ...that flow depends... on the depreciation of the rupee, that is the depreciation of sterling". The note added that at \$ 3.60 or \$ 3.70, gold exports from India would not be checked, but at \$ 3.90 they could cease. "A rise in sterling would have a deadening effect [on Indian gold exports - G.B.] which would be most unfortunate...".⁷⁰

⁶⁸ PRO T175/57, "The Present Position of the Pound", n.d. (February 1932), memorandum by Phillips.

⁶⁹ PRO T175/70, note to the Chancellor, 15 October 1932 and T172/2082, memorandum, 21 January 1933, both by Hopkins.

⁷⁰ PRO T175/57, Part 2, Phillips's memorandum of 27 and 29 February 1932 and his letter to Henderson, 26 February 1932. For similar reasons, he objected also to

Table 5
 BANK OF ENGLAND AND TREASURY HOLDINGS
 OF GOLD AND FOREIGN EXCHANGE: HALF-YEARLY,
 SEPTEMBER 1931 TO 1938

Date	Foreign Exchange	Gold
30/9/1931	12	167
30/3/1932	84	157
30/9/1932	26	226
31/3/1933	48	314
27/9/1933	20	339
27/3/1934	0	422
25/9/1934	- 2	414
27/3/1935	- 1	430
25/9/1935	- 2	497
25/3/1936	0	522
30/9/1936	- 1	639
31/3/1937	-10	716
30/9/1937	8	820
31/3/1938	- 2	835
30/9/1938	-16	710

All figures in millions of pounds at current prices and exchange rates; 0 indicates holdings less than £ 500,000.

Source: HOWSON, *Managed Float*, p. 62.

While a major objective guiding sterling policy in the early years of the float was that of sustaining gold releases from India, yet, neither the low sterling nor the liquidation (and export) of formerly hoarded assets managed to raise the Indian price level. The latter continued to fall till March 1933 and did not return to the September 1931 level (and that, too, only for brief spells) until 1935.⁷¹ In July 1934, Henry Strakosch, an adviser at the

stabilizing the sterling (and the rupee). By March 1932, British policy-makers recognised their reliance on Indian gold sufficiently as to include the Secretary of State for India in the Cabinet Committee on sterling policy. See HOWSON, *Domestic Monetary*, p. 87.

⁷¹ Calcutta Index of Wholesale Prices from *Statistical Abstracts of British India*, 1938, p. 385. Sterling receipts from gold sales were used to reduce India's foreign debt and replenish exchange reserves in London. What happened to the rupee proceeds is not as clear. Accelerated growth of bank and post-office savings deposits (TOMLIN-

India Office, expressed concern about the weakness of the Indian recovery and suggested that sterling be so managed as to promote expansion in India and in the rest of the Empire. A Treasury official, disregarding the price evidence, responded that he did not "attach much weight to Strakosch's views as to the desperate plight of India; ...the financial position is greatly improved, and there is no doubt that India is getting through the crisis better than... any other country".⁷² Earlier, Schuster had wanted the Treasury to keep primary producers' interests in mind whilst managing sterling. The official reply was non-committal, but privately the response was: "...the (Indian) tail can't expect to wag the Bulldog".⁷³

VIII

The counter-factual is an indispensable tool for some types of economic history. Were we to use the tool, we could try to answer, in final confirmation of the argument developed above, the following question. Had she faced the opposite kind of liquidity problem, i.e. one of excess supply of gold pushing up the costs of stabilizing its price or threatening to unleash world inflation, would Britain have desired that Indians import more gold? Fortunately however, we do not need to invent the counter-factual because the situation that it would have represented arose in real life!

son, *Political Economy*, p. 38) might merely reflect increased savings as urban real incomes rose; note that rural cooperative banks' deposits did not increase. According to GOLDSMITH (*Financial Development*, pp. 126-28), agricultural debt increased (Rs. 11500 million in 1929 to Rs. 18000 million in 1939) and the rural debt/income ratio doubled. A fourth of the farmer's income went towards debt servicing in 1939 (13% in 1929). In the economy as a whole, there was net dissaving.

⁷² PRO T177/12, Phillips to Hopkins, note, 20 July 1934.

⁷³ PRO T160/474 F. 12471/06/2, Viceroy to the Secretary of State, telegram, 9 March 1932, Treasury to India Office, letter, 23 March 1932 and Leith-Ross' remarks on Waley's minute of 5 March 1932. The British attitude to "Imperial" monetary policy is also discussed in DRUMMOND, *Floating Pound*, pp. 23-27.

Once the early shock had passed, the Treasury came to value the opportunity a floating sterling gave it, of pursuing domestic stability without paying much heed to the external account.⁷⁴ It also resolved that a return to fixed exchange rates and to the gold standard would not take place before the global distribution of gold improved in Britain's favour so that she had a "gold basis larger than that required by any other country".⁷⁵ But less than three years later, the sheer avalanche of gold pouring into Britain's official reserves was forcing her officials to consider the question afresh. In this section we briefly document the official response to this qualitatively new crisis.

As Table 5 shows, Britain's gold holdings more than doubled between September 1933 and March 1938. The proportion of gold and foreign exchange reserves to her imports and liabilities also rose (Table 6).⁷⁶ Meanwhile, as commodity prices and world trade failed to rise, the value of monetary gold reserves in real terms as well as in relation to the size of world trade also increased. The Economic Advisory Council (EAC), set up to advise the British government, estimated that the gold value of world trade in 1936 was only 40% of the 1929 level, while the share of annual gold output going into official reserves had risen from 33% to 125%.⁷⁷

⁷⁴ S. HOWSON and D. WINCH, *The Economic Advisory Council, 1930-39*, Cambridge, 1977, pp. 100-05.

⁷⁵ A Treasury official said, "... however inconvenient (it) ... may be when we are ... advocating economy in the use of gold, we have to face the fact that we could not risk going back to a ... gold standard without a larger share of the gold supply of the world..." PRO T175/17, Part 2, Hopkins's note of 30 March 1933 on Phillips' memorandum, "Exchange Equalization Account", 27 March 1933. One year later, the message was repeated. See PRO T172/1775, brief prepared by Phillips and Ferguson for the Chancellor, 7 March 1934.

⁷⁶ Other (Western) central banks had also reported large increases in their gold reserves. The bulk of the increase, which the New York Federal Reserve put at £ 1,000 million, came from private hoards. Per Jacobson agreed that Western hoarding of gold during 1931-1936 was "almost exactly offset by (that) dehoarded in the East...", but offered a smaller estimate of £ 400 million. PRO T177/39, Phillips to Per Jacobson, letter, 28 August 1937 and reply 3 September 1937.

⁷⁷ PRO T160/77 F. 15583, Economic Advisory Council, Committee on Economic Information, 23rd Report, *Survey of the Economic Situation*, October 1937, part 2,

Table 6
BRITISH GOLD AND FOREIGN EXCHANGE RESERVES
(AS PERCENTAGE OF HER IMPORTS
AND NET EXTERNAL LIABILITIES)

Year	Reserves/Liabilities	Reserves/Imports
1931	51%	18%
1932	53	27
1933	69	39
1934	71	60
1935	82	68
1936	98	90
1937	102	87
1938	105	73

Source: HOWSON, *Managed Float*, pp. 53-54.

This unusual situation now exercised British financial opinion which began to think of ways to eliminate it. The EAC pointed out that the accumulation of gold in New York and London "was an embarrassment".⁷⁸ Expressing regret that the minor central banks were no longer holding gold in their reserves, it feared that the burden to Britain and the USA of purchasing gold "might eventually become intolerable, if the ...output of gold remains at its present level, still more if it increased...".⁷⁹ The balance of payments of the sterling area depended on gold exports, but if the USA decided to reduce its burden either by raising the price of commodities or by revaluing the dollar, Britain would have to follow suit. Both courses of action had important implications for Britain, global stability and the future of gold.⁸⁰

Similar sentiments were expressed by Treasury officials. They feared that excessive gold supplies would destroy the met-

"International Trade, the Price Level and the Gold Problem", para. 52, table 24. All subsequent paragraph references are to this report.

⁷⁸ Para. 45 (iv).

⁷⁹ Para. 54-55.

⁸⁰ Paras. 73-76.

al's monetary role and Britain would lose the benefits that the latter implied for her balance of payments and for sterling. A "gold buyers' strike ... (was) a real imminent danger". If increased gold supplies should not affect commodity prices, "other means of absorbing gold must be found or developed", or physical supply checked, or its price lowered. Central banks could absorb gold, but those that could afford it already had all the gold they wanted. The "industrial arts and Eastern hoarders" were another prospect, but the high price was inhibiting demand and hastening their release of the metal. After considering possible ways of easing the flood and highlighting the need for and the difficulties inherent in coordinating policy with the USA, an official recognised that the problem would not be resolved quickly or easily. He was undecided about the instrument to be used, but very clear about what it should achieve. It should "stimulate consumption for industrial purposes and... check or reverse the flow of gold from the East".⁸¹

Although the growth of London's gold stocks slowed down from the autumn of 1937, the glut continued to be debated in Whitehall and in the USA through the summer of 1938. But all indications were that an agreement with the USA to relieve the glut would be as difficult to achieve in 1937/8 as a coordinated solution to the opposite problem had been in the 1920s. However, before the position could become serious enough to force British policy-makers to consider influencing macro- and reserve policies in the "east" (with the intention now of increasing gold absorption there), the issue was taken out of their hands by the evolving political situation in Europe. As war grew imminent, short-term drains resumed and sterling weakened. Late in August 1939, the Bank of England ceased to support the sterling which fell to \$ 4.03 where it was pegged when war broke out.⁸²

⁸¹ PRO T175/94 Part 1, "The Present and Future of Gold" by Phillips, July 1937.

⁸² Also see DRUMMOND, *Floating Pound*, pp. 224-48 and HOWSON, *Domestic Monetary Policies...* p. 136.

IX

Conclusion

The evidence to support the argument that Britain sought to utilise Indian gold reserves as a counter-cyclical device during the depression though mainly indirect, is inescapable. Britain's objective during the depression (and more generally in the inter-war years) of a redistribution of the world's monetary gold reserves could have been achieved through domestic adjustment, but the latter was a contentious issue in an already depressed economy. Her dependence on global expansion in the inter-war years had compelled her to try and restrict the flow of gold to India that accompanied and checked a world boom. When the world went into a slump in 1929, she turned her attention to India's private reserves of gold as an important external source of world expansion, along the lines spelt out by Keynes. The behaviour of these reserves, rather than being the spontaneous effect of the economic currents of the two periods, was induced by short-term policy.

Apart from the primary effects of the depression, macro-policy (anti-cyclical during the relatively expansionary 1920s but pro-cyclical during the 1930s) ensured that private Indian reserves would be liquidated to finance consumption or settle debts. Before 1931, this gold accumulated in the Indian portion of the gold standard reserve. In other words, the Indian householder was making up for reserve losses sustained in intervention in a manner that would have pleasantly surprised even the most convinced advocates of a "pure" gold standard. The pressure that was then mounted on the Indian government to export this gold to London should therefore be seen as the second of the two-part process by which India played her global counter-cyclical role in a fixed exchange-rate regime.

When sterling went off the gold standard in September 1931 the process, though not the underlying dynamics, changed. The

pressure on the rupee eased and intervention was no longer necessary. But distress gold sales continued in India, while sterling depreciation stimulated private exports of the metal. Once they began, sterling policy was driven by the need to secure their continuance. So successful was Britain in her effort to force gold liquidation in India and thus a redistribution of the world's monetary gold reserves that by 1937, the problem plaguing her was no longer one of "gold shortage" and deflation. Rather it was a potentially inflationary gold glut to eliminate which she began to desire a revival of the very tendency that she had tried to check since 1917 - i.e. India's large demand for gold! Now the latter, far from being alarming, became positively alluring. The wheel had come full circle.