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India as a creditor: sterling balances, 1940-1953

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TEXTO PARA DISCUSSÃO

No. 643

India as a creditor: sterling balances,
1940-1953

Marcelo de Paiva Abreu



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India as a creditor: sterling balances, 1940-1953

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Abstract

The British war effort in the Second World War depended on United States Lend Lease and the accumulation of sterling balances by neutrals, some of which would become belligerents and by the Empire. In the end of the war sterling balances corresponded to 60% of British net receipts under Lend Lease and were 15% higher than total Marshall Plan grants in 1948-52. Of the total sterling balances, about 40% were accumulated by India. This paper seeks to evaluate the costs incurred by India in the process of reduction of these balances after the war. The sources of accumulation of balances are examined and the use of the balances to repatriate India's sterling debt is described. The issue of a British counterclaim entailing a partial cancellation of Indian balances is considered. British efforts to convince India to accept a partial cancellation of the balances are analyzed singling out the crucial role of Keynes in defining British policy. The Anglo-Indian sterling balance negotiations after independence are detailed, including the disposal of balances through releases, transfer of assets to Pakistan, settlement of pensions, purchase of military stores and British gold sales. The possible contribution of British divestment to reduce outstanding balances is assessed. The Indian case is compared with those of other sterling balance holders such as Portugal, Brazil and Argentina. The links between the accumulation of sterling balances and inflation in India are considered. In the end there was a significant reduction in the purchasing power of sterling balances but not for the reasons anticipated by London.

Palavras-chave: Índia, Reino Unido, Dívida externa, Área da libra esterlina, Segunda Guerra Mundial

Britain faced enormous financial strain during the Second World War which affected her trade and financial links with the United States, with other neutrals, some of which became belligerents, and with the Empire. Payments in the dollar area were financed, after the initial Cash and Carry period, by Lend Lease. Trade and payments imbalances with neutrals and the Empire were financed by the accumulation of debt in the wake of bilateral payments agreements, or similar arrangements, combined with a drastic fall of British exports.

Accumulated sterling balances were substantial: £3,355 million by mid-1945, even if compared with the £5,504 million of transfers from the United States to Britain under Lend-Lease net of Reciprocal Aid.¹ In nominal dollars sterling balances were of the same order of magnitude of the total Marshall Plan grants from the United States to Europe in 1948-52: US\$13,521 million, at the 1945 rate of exchange, compared to US\$11,821 million of Marshall Plan grants. Indian sterling balances amounted to about a third of total sterling balances by mid-1945, and continued to rise to reach a peak of £1,321 million by the end of the year.² This was equivalent to some US\$5,284 million, rather more than the US\$4,400 million involved in the Anglo-American Loan Agreement and the Lend-Lease settlement at the end of 1945 which were, however, fully convertible.

The size of such balances constrained the British authorities to consider their payment only in the long term. And there were additional features of the Indian balances which made their reduction even more complex than other negotiations affecting sterling balance holders.

A significant share of Indian balances had been accumulated as a result of British war expenditures in India, as defined by the Financial Agreement of 1940 between Britain and India, on how to share defence costs before military operations spread to the East. A further sore point from the British point of view was that Burma, the main war theatre in the vicinity of India in the war against Japan, had been administratively detached from India in 1937, so that military operations there were considered to be abroad and not an Indian liability.

The settlement of Indian sterling balances was also made more difficult by the fact that before 1944, India had repatriated most Indian sterling loans floated in London. And there was no possibility of settlement of sterling balances by the sale of British direct investment as was the case in many other countries holding sterling balances, notably in South America.

To reduce British debt London relied mainly on the postponement of settlement and the minimization of interest paid on balances. By the early 1950s the Indian sterling balance problem had been brought under control by such measures and the increase of India imports from the United Kingdom. The final step in 1953 was a release timetable in line with the Colombo Plan, together with an Indian commitment to hold a sizeable sterling reserve in London.

¹ Sayers, *Financial policy*, pp. 439, 531 and 535

² Sayers, *Financial policy*, p. 259.

While frequent reference is made here to other sterling balance holders, the focus is on the accumulation and disposal of sterling balances by British India until partition and by India afterwards. It is divided into seven sections besides this introduction. The first section focuses on the accumulation of sterling balances between 1939 and 1946. Section 2 is on the uses of sterling balances during the war, mainly through the repatriation of the Indian sterling debt. The third section centers on the controversial proposals to partially cancel the Indian balances based on a British counterclaim for an increased Indian share of military expenditures. Section 4 is on the Anglo-Indian sterling balances negotiations between 1947 and 1953. The next section analyses the reduction of the balances after 1947. This includes releases, transfer of assets to Pakistan resulting from the partition, settlement of pensions, purchases of military stores and British gold sales. It also deals with the possible contribution of British divestment to reduce Indian sterling balances. Section 6 is on the role of wartime inflation in India as a factor to explain the increase in balances outstanding, especially after 1942. Section 7 centers on the evaluation of costs involved in the adoption of a range of measures on the disposal of Indian sterling balances. It includes comparisons with other sterling balance holders.

I

Indian sterling balances increased during the war partly because of the Indian trade and invisibles surplus with Britain, partly because of war expenditures by Great Britain in India (see Table 1 below). The accumulation of Indian sterling balances depended crucially on British military expenditures, but critics tended to disregard other sources of accumulation of balances.

Table 1
India: Sources of sterling, 1939-1946, £ million

| | Balance of trade and net invisibles | War expenditure | Other sources | Total |
|-------------------------|-------------------------------------|-----------------|---------------|-------|
| September 1939-March 40 | 65 | 2 | 13 | 80 |
| 1940-41 | 57 | 30 | 6 | 93 |
| 1941-42 | 73 | 146 | 6 | 225 |
| 1942-43 | 92 | 244 | 7 | 343 |
| 1943-44 | 105 | 289 | 3 | 397 |
| 1944-45 | 92 | 308 | 2 | 402 |
| 1945-46 | 70 | 282 | 3 | 355 |
| Total | 554 | 1301 | 40 | 1895 |

Source: Indian sterling balances, p.2, 15 Jan.1.1947, Bank of England (BoE), OV56/55.

In 1938-9 the Chatfield Committee on the defence of India defined a modernization programme. After the outbreak of the war in Europe, a Financial Settlement was reached in early 1940, almost two years before Japan entered the war. Britain was to pay: 75 per cent of the costs related to the modernization of the Indian Army; the full cost of Indian troops additional to the peace-time establishment raised for service abroad; the cost of

military stores supplied by India for all British military forces in the Middle East; the war-time increase in costs related to external defence forces which existed before the war but were subsequently sent abroad; the cost of special measures required by His Majesty's Government. India was to pay, besides the 25 per cent as per Chatfield, an allowance for inflation, and the cost of war measures undertaken in India's own interests; £750,000 towards the cost of maintaining Indian external defence troops overseas.³ As mentioned above, a crucial element to explain British future grievances was the fact that Burma had been detached from India in 1937. As Burma would become the main theater of British military operations in the region the costs fell on Britain rather than on India as such operations were outside India.⁴

In spite of worries in London about the rate of accumulation of Indian sterling balances -- 'when the bath is overflowing the tap should first be turned off before steps be taken to mop up the water in the floor' -- British yearly war expenditure in India in the last three years of the war remained substantial at around £300 million (see Table 1).⁵

Taking the war period as a whole contributions by Britain and India to defence expenditure were similar.⁶ The British official history considered that the British criticisms about the unfair division of the war burden between Britain and India were 'coloured ... by the earlier phase [of the war]'.⁷

The possibility of revising the 1940 settlement was repeatedly raised by those favouring a British counterclaim. In 1942 there was the possibility of adding £27 million/year plus £29 million non-recurrent to the Indian contribution but this was not accepted by the British Government, as it would have involved the abandonment of the claim envisaged by Churchill and the Treasury. Thus, as put by the British official historian 'the Treasury was reluctant to grasp the one bird at the price of forever abjuring the hypothetical birds that remained in the bush'.⁸ The cost of this decision was £100 million.

Based on the evidence about how the war financial burden was shared between India and Great Britain, the British official historian was critical of Churchill's claim that 'no great portion of the world was so effectively protected from the horrors and perils of the World war as were the peoples of Hindustan. They were carried through the struggle on the shoulders of our small island.'⁹

³ Sinha and Khera, *Indian war economy*, pp. 146-95 and 306-18 and Hall, Wrigley and Scott, *Studies in overseas supply*, pp. 437-8.

⁴ Pressnell, *External economic policy*, p. 218.

⁵ Henderson's [Economic Adviser, H.M. Treasury] memo on Indian inflation and sterling balances, 20 Sept. 1943, TNA:T236/148.

⁶ Up to 31 March 1947 the United Kingdom spent £1380 million and India £1430 million Appendix V, Cabinet Working Party on Sterling Balances, 8 Nov. 1949, E.D. (W.) (49) 11, TNA:T236/2684, p. 29.

⁷ Sayers, *Financial policy*, p. 254.

⁸ Sayers, *Financial policy*, p. 261,

⁹ Churchill, *Second World War*, p. 181 and Sayers, *Financial policy*, pp. 271-2.

II

The most important use of the sterling balances during the war was the repatriation of the Indian sterling debt and purchase of railways. Such possibilities were exhausted by 1943. Purchases in other Allies, such as the Dominions and the US played some role as well as sales of gold by the British authorities (see Table 2). But the stock of sterling balances, which was held overwhelmingly by the Reserve Bank of India, increased rapidly (see table 3)

Table 2

India: Uses of sterling, 1939-1946, £ million

| | Repatriation of debt | Purchase of railways | Gold sales | Purchase in Dominions and USA | Other uses | Total |
|--------------------|----------------------|----------------------|------------|-------------------------------|------------|-------|
| Sept 1939-March 40 | 17 | 0 | 0 | 0 | 4 | 21 |
| 1940-41* | 67 | 2 | 0 | 4 | 19 | 92 |
| 1941-42 | 82 | 4 | 0 | 8 | 28 | 122 |
| 1942-43 | 122 | 15 | 0 | 26 | 9 | 172 |
| 1943-44 | 12 | 2 | 32 | 21 | 2 | 69 |
| 1944-45 | 0 | 9 | 24 | 33 | 24 | 90 |
| 1945-46 | 0 | 2 | 17 | 34 | 31 | 84 |
| Total | 300 | 34 | 73 | 126 | 117 | 650 |

*1 April 1940 to 31 March 1941.

Source: Indian sterling balances, 15 Jan. 1947, page 5, BoE:OV56/55.

Repatriation of Indian loans played a decisive role to keep Indian sterling balances under control until mid-1943. Repatriation rose from £17 million (face value) in 1939/40 to £71 million in 1940/1, £99 million in 1941/2 and £119 million in 1942/3. It became almost insignificant afterwards, totaling about £19 million up to 1947/8.¹⁰

Most of the repatriated loans carried 3 or 3.5 per cent interest rates. Repatriation at first through open market purchases was made compulsory by a succession of schemes in 1941 and 1942. There were criticisms at the time in the British press claiming that there had been breaches of contract as loans were compulsorily redeemed before contractual redemption. But this had also been the case of United States and Canadian loans.¹¹

Of the total face value redeemed of £308.5 million until 1947/8, only 11.5 per cent were by open market purchases, about 20 per cent referred to the 3.5 per cent 1931 sterling stock, mostly in 1942/3, another 20 per cent to railway annuities and debentures and about half was evenly split between the two compulsory schemes of 1941. There is some controversy on how costly it was for India to delay the data base to fix minimum

¹⁰ Dhar, *Sterling balances*, pp. 9-56 and Simha, *Reserve Bank of India*, pp. 377-404.

¹¹ Sayers, *Financial policy*, pp. 257-8 points out that the borrower had not broken faith as the British Treasury that had exercised compulsory powers.

purchase prices as quotations rose in early 1941. The more balanced analyses suggest that losses were limited.¹²

In the long term, as India accumulated massive sterling balances earning little more than 0.5 per cent yearly, the redemption of sterling loans earning interest in the region of 3 per cent yearly turned out to be by far the most favourable employment of sterling balances.

III

Japan's entry into the war in the end of 1941 had important repercussions on the British arrangements to finance the war as the possibility of an East Asian theatre of operations close to India had not been envisaged by British strategists. The issue of whether Britain should press for a renegotiation of the 1940 Financial Settlement remained unsolved until the end of the war. But it caused many frictions between those in favour of Britain presenting a counterclaim to reduce its indebtedness to India – Churchill, Cherwell, Keynes, the Treasury -- and those opposing it – the India Office in London, the Government of India and the Viceroy.¹³

Table 3

India: Sources and uses of sterling, 1939-1946, £ million

| | Sources | Uses | Net accumulation of sterling holdings by the RBI | End of period stock of sterling balances* |
|----------------------|---------|------|--|---|
| Sept 1939-March 1940 | 80 | 21 | 59 | 107 |
| 1940-41 | 93 | 92 | 1 | 108 |
| 1941-42 | 225 | 122 | 103 | 211 |
| 1942-43 | 343 | 172 | 171 | 382 |
| 1943-44 | 397 | 69 | 328 | 710 |
| 1944-45 | 402 | 90 | 312 | 1022 |
| 1945-46 | 355 | 84 | 271 | 1293 |
| Total | 1895 | 650 | 1245 | |

*£48 million held at the beginning of September 1939.

Source: Indian sterling balances, 15 January 1947, page 2, BoE:OV56/55.

By the end of 1941 Keynes was already concerned with the accumulation of sterling balances and thought that the balances 'ought to be funded or blocked at the end of the war' although such an intention should not be disclosed.¹⁴ Keynes thought that perhaps some mitigation could be sought 'if we charged India... for all they get under Lend Lease'.¹⁵

¹² Dhar, *Sterling balances*, pp. 9, 35-6 and 55.

¹³ Keynes was back at the Treasury, 1940-46; Cherwell was Personal Assistant to Churchill and Paymaster-General 1942-45. See Pressnell, *External economic policy*, pp. 216-23 on Indian pre-1946 sterling balances.

¹⁴ Keynes to Hawtrey, 13 Oct. 1941, quoted by Pressnell, *External economic policy*, p.96.

¹⁵ Keynes to Phillips, 14 Jan. 1942, Keynes, *War finance*, p. 223.

Early pressures for the revision of the 1940 Financial Settlement started to take shape in the Treasury in mid-1942. Roosevelt's statement on contributions to the war effort and that there should be no war debts after the war between United Nations partners was quoted and served the basis to press for a review. The Financial Agreement with India was claimed in London to be inconsistent with this view as the underlying assumption was that the war was not an Indian affair. This was argued to be no longer tenable as very large payments resulted from it and the repatriation of Indian debt was exhausted. 'The very large sums that are being spent in India for war purposes impoverish us and enriches India. On this ground alone a revision is called for.'¹⁶

Keynes suggested four different methods to deal with the rising Indian balances; i) India would pay a lump sum related to war expenditure; ii) a new way of sharing with the United Kingdom; iii) India to incur in all defence expenditures inside India; iv) detailed modifications.¹⁷ These moves in favour of a revision of the 1940 Financial Settlement were countered by the Government of India and the India Office. They argued India was too poor, a large part of the balances was unconnected with defence, that the political consequences would be deplorable, and either ceasing to draw goods and services, or ceasing to pay, would have disastrous consequences on India's participation in the war.¹⁸

In the discussion in the Cabinet in mid-1942, with Churchill absent, it was decided to postpone the decision on the revision of the arrangement.. Sir Jeremy Raisman, the Financial Member of the Government of India, who was present, raised the possibility of lessening the problem through the building up of a reconstruction fund, the capitalization of pensions and the need to keep a large currency reserve.¹⁹

Leo Amery, Secretary of State for India and Burma, wrote to Kingsley Wood, Chancellor of the Exchequer, to register that the Cabinet had been against a revision of the settlement and dismissed worries about the sterling balances as there would be significant postwar purchases of capital goods. Keynes, with some reason, thought that Amery was a 'dangerous lunatic'.²⁰

When Churchill returned it was agreed that the Financial Settlement should stand, but that the Government of India should be informed that the issue would have to be raised the future.²¹ Churchill was vehement in his criticisms of the arrangements with India: 'are we to incur hundreds of millions of debt for defending India in order to be kicked out by the Indians afterwards? This may be an ill-contrived world but not so ill-contrived as all

¹⁶ War Cabinet Paper W.P. (42) 325, Indian Sterling balances, memorandum by the Chancellor of the Exchequer, 30 July 1942, Mansergh, *Quit India*, pp. 504-8.

¹⁷ Hawtrey, Chronicle 1942, TNA:T208/204.

¹⁸ Linlithgow [Viceroy of India, 1936-43] to Amery, Tel. 2255, 31 July 1942, #379 (number of document) and W.P. (42) 328, SS India Memo on Indian Sterling Balances, , 1 Aug. 1942, #389, Mansergh, *Quit India*..

¹⁹ War Cabinet (42) 105th Conclusions, War Financial Settlement of 1940 and Indian Sterling Balances, 6 Aug. 1942, #435, Mansergh, *Quit India*.

²⁰ Amery to Wood, 7 Aug. .1942, #457, Mansergh, *Quit India*, Keynes, *War finance*, p. 332.

²¹ Amery to Churchill, 27 Oct. 1942, Indian Sterling Balances, Mansergh, *Reassertion of authority* and War Cabinet W.M. (42) 125th Conclusions, 16 Sept. 1942, #750, Mansergh, *Quit India*.

that.' ²² In what has been referred to as 'mild act of mutiny', Raisman in his Budget Speech of 28 February 1943 omitted to include 'at present' in the end of his statement that 'HMG do not intend to pursue the proposal to modify the character of the present Financial Agreement'. ²³

The tensions between Churchill, Cherwell and the Treasury and, on other hand, Amery, the Viceroy and the Government of India, would recur. In September 1942, Keynes was still thinking that the sterling balances could be settled by funding a part for capital development, by building up currency in gold and dollars and by holding quasi permanent currency reserves in the form of Treasury Bills to be drawn only by mutual agreement. By February 1943, he proposed a solution that would involve, besides a development fund, capitalization of pensions, the building up of reserves, and a cap on the accumulation of sterling balances to be assured by increasing India's share of war expenses. ²⁴

In July 1943 what has been called the "Winstonian volcano" erupted again. Churchill raised the counterclaim issue, talking of 'black spots' in the arrangements to finance the war. ²⁵ Amery wrongly detected Keynes's influence on Churchill on the advice of a repudiation of the whole indebtedness to India. ²⁶ He was sharp in his criticism of Churchill's stance. He sounds persuasive: 'when driving to the station to catch a life or death train, you may well reflect whether your conscience or necessity will compel you to bilk your taxi man when you get there. But I should hardly think that you, with your customary prudence, would put your head through the window halfway and tell the cabby man that you have no intention of paying when you get there as you mean to raise a counter-claim for all the indirect service you have rendered him in your capacity as a faithful steward of the Nation's finances'. ²⁷

The British press stressed the generosity of the initial settlement and its remarkable lack of realism.. It had revolutionized the debtor-creditor relations of the two countries and was bestowing on India one of the most pronounced inflations experienced by any belligerent country. ²⁸

Cherwell was again active in the provision of what Amery thought was 'silly' advice to Churchill. Meetings of the Indian Financial Committee were rather stormy, with Cherwell's allegations that India had grossly overcharged for supplies met by sharp

²² Toye, *Churchill's empire*, pp. 237-8, quoting Barnes and Nicholson, *Empire at bay*, p.836.

²³ Tomlinson, 'Indo-British relations', p 144 and Young's [H.M. Treasury] note, 28 Feb. 1947, TNA:T236/1114. Wavell [Viceroy of India, 1943-47] to Pethick-Lawrence [Secretary of State for India, 1945-47], 26 Feb.1947, #469, Mansergh et al, *Fixing a time limit*.

²⁴ Supplementary notes on our prospective dollar balances, 30 Sept. 1942, and Indian Sterling Balances, 3 Feb.1943, Keynes, *War finance*, pp. 260-1 and 334-5.

²⁵ War Cabinet (43) 106th Conclusions, 27 July 1943, #61, and Amery to Linlithgow, 28 July 1943, #64, Mansergh and Munby, *Bengal famine*.

²⁶ Amery's diary, 19 July 1943, Barnes and Nicholson, *Empire at bay*, p. 899. There is no evidence of Keynes ever proposing full cancellation.

²⁷ Amery to Wood, 28 July 1943, #63, Mansergh and Munby, *Bengal famine*..

²⁸ *The Economist*, 7 Aug. 1943.

criticism from other members.²⁹ Amery thought that his allegations were 'arrant nonsense'. That he was nearer the truth than Cherwell is backed by the British official history.³⁰

There was optimism among British officials about India agreeing to cancellation of the balances. It was thought that 'at the end of the last war India made a contribution of £100 million. This time the amount would have to be much more'.³¹ Or that the 'Government of India could be induced to give £200 million. A settlement negotiated by agreement could fairly be represented as honourable and free from suggestion of default'.³²

Keynes in 1943 considered further schemes to deal with the Indian balances. From mid-1943 he resurrected arguments rooted in the controversies about war debts in the 1920s and 1930s. In the mid-1920s he already "sympathized" with the distinction made by Etienne Clémentel, the French minister of finance, calling war debts 'political' debts, and the other obligations of the French government 'commercial debts'.³³

In the early 1930s, after the Hoover moratorium, Keynes had developed the arguments later used to attempt to justify a low rate of interest on sterling balances: 'there are not now or never were any profitable assets corresponding to the sums borrowed. The medieval Church was wise to make a fundamental distinction between usury and a share in emergent profits. The war debts are a case of pure usury [...] It would be a good, not a bad precedent for the future, to establish a distinction between money lent internationally to foster a war and money to build, for example, a railway [...] If I lend money to a friend to help him out of a tight place, where there can be no question of his earning a profit, I expect no more than the repayment of my loan'.³⁴

The 1943 version of the argument was that 'the investment or lending analogy, which would call for the payment of interest to individuals, is entirely false as between Allied governments... the expenditure, which gave rise to the debt, has not given rise to an interest- and profit-earning asset. This is dead-weight debt incurred largely ... for the defence of India... it is entirely inappropriate that the sum should be regarded as proper subject for usury.' In sum, these were war debts, not commercial debts. "The key [solution] is to be found in the avoidance of interest charges'.³⁵ Keynes also raised the

²⁹ Amery to Linlithgow, 17 Aug. 1943, #85, Mansergh and Munby, *Bengal famine*.

³⁰ Amery's diary, 31 Aug. 1943, Barnes and Nicholson, *Empire at bay*, p. 936. Sayers, *Financial policy*, pp. 254-5, reports the findings of British committees that dismissed views that HMG 'has not had value for money'. For an unsatisfactory attempt to redeem Cherwell's stance on India, see Birkenhead, *Prof in the world*, Appendix III.

³¹ Catto's [Financial Adviser, H.M. Treasury, 1939-44] memo, India's Sterling Balances, 9 Aug. 1943, TNA:T236/148.

³² Eady's [Joint Second Secretary, H.M. Treasury] memo on Indian Finance Committee, 7 Feb. 1944, TNA:T236/1111, reporting Kisch's (India Office) view.

³³ *The Nation and the Athenaeum*, 10 Jan. 1925, Keynes, *End of reparations*, p.264.

³⁴ *Daily Mail*, 12 Dec. 1932, *End of reparations*, 1978, p. 383.

³⁵ Keynes to Eady, The problem of India's sterling balances, 10 Aug. 1943, and The Indian sterling balances, 17 Dec. 1943, Keynes, *War finance*, pp. 337 and 341-7.

rather debatable argument that a lower rate than that paid on British holders of domestic debt was justified because the Indians would not pay British tax on it.³⁶

He was radical in his condemnation of what had been a muddled decision in the past: after the last war 'we humbugged to the end – though the end came almost immediately – on the basis of accepting the commercial analogy. And thereby we lost our honour and dignity, as well as our good word and **any** reputation we may have possessed for common sense and good management'.³⁷

In mid-1943 he submitted a specific proposal. Of the £750 million sterling balances, £100 million would be transferred to India as currency reserve, a further £250 million would be freed only when the £100 million had been exhausted in meeting adverse balance of payments, £200 million (no interest earned) would be set aside to pay pensions and £200 million (no interest earned) to be freed three years after the end of the war at the rate of £20 million yearly.³⁸

The British Cabinet reasserted in mid-1944 its stance of 1942, that the settlement of 1940 was no longer appropriate and that Britain was entitled to seek a readjustment of the position, which would take into account the extent to which the British, in India and elsewhere, had contributed to save India from invasion.³⁹

Repudiationists, as they were called in India, kept active. Cherwell held the extreme views. He argued that there was 'need for drastic treatment of Indian sterling balances, ... they should not be funded, but should be drastically scaled down' and envisaged unilateral action by Britain.⁴⁰ Keynes promptly advised against it.⁴¹ In early 1945 Cherwell suggested that India should be paid just half of the sterling balances. For Amery it 'sounded like a memory from another world. Unfortunately that other world is the one Winston still lives in'.⁴² The British press backed the more sanguine stance on Indian balances.⁴³

Even more serene views, such as those of Sir John Anderson, the Chancellor of the Exchequer, concurred: 'it is contrary to elementary principles of justice and fair dealing between nations that [such] obligations should be treated as ordinary commercial debt'. This implied that no or very low interest would be paid on the balances. It was thought that 'capitalization of war-time assets on a commercial basis has gone (by debt

³⁶ Pressnell, *External economic policy*, p. 221.

³⁷ Memo on The problem of our external finance in the transition, 12 June 1944, Keynes, *Transition to peace*, p. 48.

³⁸ Hawtrey's [Director of Financial Enquiries, H.M. Treasury], *Chronicle* 1943, p. 14, TNA:T208/204. In the end of 1943 Keynes presented still another proposal increasing the pension fund provision and the capital development fund, memo, 17 Dec. 1943, TNA:T236/1142.

³⁹ War Cabinet W.M. (44), 102nd Conclusions, 4 Aug. 1944, #629, Mansergh, *Bengal famine*.

⁴⁰ See Mukerjee, *Churchill's secret war*, for Cherwell's extreme views on India and his influence on Churchill.

⁴¹ Pressnell, *External economic policy*, pp.163-4.

⁴² Barnes and Nicholson, *Empire at bay*, p. 1025.

⁴³ *The Economist*, 3 June 1944, was hawkish, arguing that 'the bigger that claim the smaller becomes the chance of converting it from its present virtually blocked character into a multilaterally convertible asset'.

repatriation) as far as is reasonable'. Britain 'cannot afford to allow India to invest her sterling in ordinary British securities [as] our balance of payment could not stand the burden [of 4% on £1,250 million]'.⁴⁴ Business circles in India insisted that the balances were commercial obligations, and that 2 per cent was the minimum acceptable interest rate.⁴⁵

Keynes's statement at the Bretton Woods conference in July 1944 on the Indian sterling balances provoked sharp reactions in India. He opposed the Indian intentions of including the settlement of such balances in the multilateral agenda stating that it should be a matter between those directly concerned. He added ominously: 'When the end is reached and we can see our way into the daylight we shall take it up without delay, to settle honourably what was honourably and generously given'.⁴⁶ Voices from India and the India Office underlined the need to deny cancellation. The Viceroy of India, Lord Wavell, in late 1944, and the Labour Secretary of State for India, Pethick-Lawrence reacted to Keynes's ideas about scaling down the Indian balances. Without ruling out some countercharges Pethick-Lawrence he advised against 'a frontal attack on capital' and instead should aim at securing acceptable rates of interest and periods of repayment.⁴⁷

The 1945 Anglo-American Financial Agreement had important implications on the sterling balances issue. The United States was keen to guarantee that the loan proceeds were not used by the United Kingdom to settle its wartime debts. It explicitly referred to the division of balances into three categories: to be released immediately, to be released after a five-year period and 'to be adjusted as a contribution to the settlement of war and postwar indebtedness'.⁴⁸

There was, of course, an outcry in India, but Keynes defended his stance on Indian balances: 'we are not committed to insist on India's acceptance of cancellation. If India prefers to stand out, she would be free hereafter to use at her discretion for current transactions her post-war earnings of sterling and other currencies but her war-time accumulations would only be repaid and become available to her out of any surplus we might be prepared to release to her *after* we had met our obligations to the US and to the sterling area countries entering the general scheme'.⁴⁹

⁴⁴ Anderson, Budget speech, 24 April 1945, HMG Materials on Indian Sterling Balances Negotiations, BoE:OV56/55, Note on India Summary of I.F. (44) 12, 18.8.44, TNA:T236/1111 and Rowe-Dutton [Third Secretary, H.M. Treasury] to Eady, 17 August 1945, TNA:T236/1112. Keynes and Cherwell mentioned in late 1943 the possibility that cancellation could be coupled with a rupee devaluation to avoid an unfavourable impact on the Reserve Bank of India balance sheet but nothing came of it, Hawtrey's Chronicle 1943, pp. 16-7, TNA:T208/204 and Meade, *Cabinet Office*, p. 226..

⁴⁵ Mukherjee, 'Indo-British finance', pp.230 and 250. Pandit Nehru wrote in 1946 that postwar Britain would face severe difficulties due to the interest rate of 5% that would be applied to the 'frozen sterling credits', Nehru, *Discovery of India*, p. 605.

⁴⁶ Statement by Lord Keynes on behalf of the Delegation of the United Kingdom at Meeting of Commission I, Keynes, *Shaping the post-war world*, pp. 86-7.

⁴⁷ Note by Wavell, 5 Sept. 1944, #4, and Wavell to Amery, 26 Oct. 1944, Tel 17, #69, Mansergh, 1975. Memo by Pethick-Lawrence, Washington Talks, 30 Oct. 1945, TNA:T236/1656.

⁴⁸ United States, *Anglo-American Financial Agreement*, section 10.

⁴⁹ Keynes to Dalton [Chancellor of the Exchequer, 1945-47], telegram Nabob 233, 29.10.45, Bullen and Pelly, *United States loan*, p. 276.

The Labour administration, and especially Dalton, pursued partial cancellation with full backing of the Treasury and the Bank of England. In the Commons in late 1945 Dalton stated that: 'this great load of debt ... is a strange and ironical reward for all we suffered for the common cause'. Churchill raised the counterclaim issue again and referred to his past reservations on the subject.⁵⁰ Officials were aiming at a cancellation of £270 million of Indian sterling balances, about a quarter of the total.⁵¹ Prime Minister Clement Attlee in early 1946 insisted that "there could be no question of offering, at this stage, concessions [to India] on the financial side in order to secure political settlement".⁵² When discussing the matter in the Cabinet in late 1946, Pethick-Lawrence, mentioned that if the Indian Constitution had *ultra vires* implications 'there were the sterling balances'. Attlee, however, pointed out the complications involved in the balances being owned by the Reserve Bank of India and in their distribution between 'different parts of India'.⁵³ In sharp contrast, Pandit Nehru, writing in 1946, passionately portrayed the sterling balances as representing 'the hunger, famine, epidemics, emasculation, weakened resistance, stunted growth, and death by starvation and disease of vast numbers of human beings in India'.⁵⁴

Keynes, in early 1946, thought it might be confirmed that there would be no unilateral writing-down of balances but 'it seemed to him absurd to construe it as implying that HMG could not make any suggestion of a reduction'. The Cabinet decided to make no further statement on the matter.⁵⁵ "Otto" Clarke in late 1946 thought that no country would be willing to cancel, but cancellation and the rate of interest were really the same thing and that if Britain could get the Indians to agree to 1/2% this would be equivalent to a cancellation of some 30%. In any case it was not expected that all the sterling balances would ever be repaid.⁵⁶

Even before his mission to India in early 1947 for preliminary negotiations on sterling balances, Sir Wilfred Eady, Second Secretary of the Treasury, had been pessimistic on cancellation and thought that it made more sense to concentrate on low rate of interest

⁵⁰ Eady to Dalton, 21 Jan. 1946, TNA: T236/1113; Treasury meeting, 30 Jan. 1946, TNA:T236/1656; Indian Sterling Balances Negotiations, 15 Jan. 1947, BOE: OV56/55.

⁵¹ The United States Financial Agreement as it affects relations with the Sterling Area, SAN(46) 4, 8.Feb. 1946, T236/1656.

⁵² Dalton to Pethick-Lawrence, 11 March 1946, quoted by Tomlinson, *Political Economy of the Raj*, p. 147.

⁵³ Meeting in Downing Street on Indian Conference in London, 5 Dec. 1946, #157 and #159, Mansergh, *Interim government*.

⁵⁴ Nehru, *Discovery of India*, p. 561.

⁵⁵ Cabinet. Minutes of an ad hoc Committee on Financial and Commercial Policy, GEN 89/7th meeting, 7 Feb. 1946, also present Keynes and Bridges [Permanent Secretary, H. Treasury], # 409, Mansergh and Moon, *Post-war phase*.

⁵⁶ Clark [Assistant Secretary, H.M. Treasury] to Rowe-Dutton, 7 Dec. 1946, TNA:T236/1117.

and limitation of releases.⁵⁷ Dalton remained combative.⁵⁸ At the same time British Government of India officials were insisting that there would be no scaling down.⁵⁹

In early 1947 Churchill raised the counterclaim issue by asking in the Commons whether the Viceroy of India had not been notified in 1942 by the last government that Great Britain reserved full rights to present a counterclaim to India on war purchases.⁶⁰ Churchill's memory served him well as, as mentioned before, the right of raising the counterclaim had been reserved in 1942 and, in fact, again in 1944. But he did not know about Raisman's omission of the crucial 'at present'.⁶¹

There was successful damage control to avoid Churchill's mention in Parliament to Raisman's speech in the Commons as this would weaken the British stance of still seeking to reduce the balances.⁶² The financial press continued to back the more extreme views in favour of cancellation: 'Britain must put forward counterclaims, based on the principle of equal sacrifice, and calculated on the basis of her excessive financial war efforts and of the inadequacy of the war efforts of the creditor countries ...[counterclaims] must be presented, not as a request for a favour but as a right'.⁶³

Pressure for cancellation peaked with Dalton's speech of 6 May 1947 addressing the Brazilian Chamber of Commerce: 'this vast [British] accumulation of debts represents an unreal, unjust and unsupportable burden... Sooner or later this must be substantially scaled down. Britain is strong, but one sign of her strength must be a refusal to take on fantastic commitments which are beyond her strength and beyond all limits of good sense and fair play'.⁶⁴ It caused dismay in India, including in the Government of India, and Mountbatten protested strongly.⁶⁵

IV

Wilfred Eady and Cameron Cobbold, Deputy Governor of the Bank of England, visited India in early 1947 and had preliminary talks with officials of the transitional Indian administration on the disposal of sterling balances.⁶⁶

⁵⁷ SAN 4th meeting in the Treasury, 25 Jan. 1947, BoE: OV56/19.

⁵⁸ As shown by his jottings addressed to Eady on a letter from Catto of 23 April 1947: 'what about counterclaims for having saved the creditors [of] yours from Huns and Japs?', TNA: T236/2684.

⁵⁹ Jones's [Principal Secretary, Finance Department, Government of India] speech in the Council of State of India, Press Information Bureau Government of India, 17 March 1947, TNA: T236/1114.

⁶⁰ Tel UKRI 97, Cabinet Office to Eady, 10 Feb. 1947, BoE:OV56/19.

⁶¹ Memo on Indian Sterling Balances, 26 Feb. 1947, TNA:T236/1114, mentioning W.P. (44) 398.

⁶² Treasury? Minute, 6 March 1947, TNA:T236/1114.

⁶³ *Financial Times*, 7 March 1947.

⁶⁴ Abreu, 'Brazil as a creditor', p. 459.

⁶⁵ Simha, *Reserve Bank of India*, p. 619; telegram 3625, Government of India Finance Department to Secretary of State for India, 10 May 1947, TNA: T236/1114, and telegram 2912-S, Mountbatten to Attlee, 24 July 1947, #221, Mansergh et al, *Mountbatten Viceroyalty*

⁶⁶ Dadabhoy, *Barons of banking*, ch. 21 presents a succinct description of sterling balances issues with no attempt to evaluate negotiation results or comparisons with other holders.

British intentions in the forthcoming negotiations with independent India were discussed in London early in 1947. The idea was to apply Keynes's formula and divide the balances into three parts: one to be released in a five-year period, another to be released on installments after 1951, the other to be 'adjusted'. When Keynes had proposed this solution the prospect was that the United States would be more generous towards the United Kingdom than it actually was the case. Release of one third of the balances in 5 years was now impossible and no commitment could be made beyond 5 years. It was thought to be absurd to pay interest on such balances but "so far convention has been too much for us and we have failed to get acceptance of the doctrine of no interest at all". Interest on balances above the pre-war level should be limited to 0.5 per cent. The United Kingdom should reserve the right to claim adjustment of the balances. The spirit in the Treasury was that 'at best these debts can only be worked off over 30/40 years or more. It is extremely unlikely that history will ever record that they were in fact paid in full. All manner of events may cause cancellation of a large part of them.'⁶⁷

As already mentioned, before leaving for India, Eady had stated his views that to seek cancellation was unrealistic and that it was more important to concentrate on a low rate of interest and a limitation of releases.⁶⁸ But the financial press thought that 'writing off may well arise both on grounds of equity and because the Anglo-American Financial Agreement contemplates it'. It was "unfair that debt incurred at inflated prices should be paid by exports invoiced at relatively uninflated sterling prices."⁶⁹

Eady from Delhi informed that any form of cancellation by agreement as contribution to the war effort would have to be ruled out. The Indians pressed for a reasonable interest rate and were informed that Britain would pay no more than 0.5 per cent. Eady argued that to secure 0.5 per cent the Indians would have either to sell their middle and long-term securities or accept no interest on the rest of the balances and that "we should not be doing badly if we left them to earn the average rate they are now earning."⁷⁰

Reviewing the negotiations after his return from India, Eady made a summary of the talks in Delhi. He had reasserted Keynes's stance: that 'our debt with India was a war debt. It had been incurred under conditions of the war and for the purposes of the war. It had left no productive assets behind it which could contribute to the amortization of the debt. This is the definition of a war debt'. But thought that a 'claim for an adjustment does not rest on argument about overcharging'. He had recognized the Indian war effort but added the

⁶⁷ Eady memo, Further negotiations on Sterling balances, 25 April 1947, TNA:T236/2684. Hawkish views were widespread in academic circles. Harrod in *Are these hardships necessary?*, p. 56, while acknowledging that 'primitive peoples who have struggled in hard conditions through centuries, which we cannot count, must be educated and raised to a higher degree of civilization' thought that there was 'no imperative categorical reason to take action for another two, three or five years', quoted by Abreu, 'Brazil as a creditor', pp. 460-1.

⁶⁸ Sterling balances negotiations with India, minutes of SAN 4th meeting, 25 Jan. 1947, BoE:OV56/19. Eady had been already advised by Rowlands [Finance Member of the Viceroy's of India Executive Council] in late 1945 that any Indian cancellation was unlikely, Eady to Brand, 22 Dec. 1945, in Bullen and Pelly, *Britain and America*, p. 15.

⁶⁹ *The Economist*, 1 Feb. 1947. For the 'relatively uninflated' British prices see footnotes 127 and 129 below.

⁷⁰ Tel IRKU 123, 11 Feb. 1947, BoE:OV56/19.

surprising assertion that 'India [was] still living under conditions of austerity comparable to our own' and that a 'debt of this size does not make economic sense'. In any case it was more important to concentrate on a low rate of interest and a limitation of releases rather than on cancellation. An element of cancellation was present in the possible capital transactions proposed by the British: £200 million on purchase of stores and fixed installations and £250 million on the capitalization of pensions. Eady mentioned to the Indians as non negotiable releases of £150 million over 5 years and no commitment beyond this and added that 'it was not fair to India (sic) to introduce bargaining on such a crucial issue'.⁷¹

The Indians insisted both on a significant interest rate and releases of £250-300 million. Narahari Rao, Finance Secretary, Government of India, privately accepted adjustments, but talks 'went downhill' and the Indian side mentioned that the gap between the two sides was too wide.⁷² Eady stated that it was a mistake to believe that 'moving things to a political level' would improve terms. He claimed that 'we spoke very sharply to them about their failure in taking responsibility and their stupidity, calling their attention to the obvious fact that the opinion in the U.K. was hardening about the war obligations and the burden they put on the hard-pressed British economy' and that 'blackmail [is] an ugly word for an ugly thing and they would be wise to remember that'. The bottom line according to Eady was that cancellation was difficult, 0.5 per cent on all balances perhaps possible and that the British releases offer could not be improved. But he insisted that the crucial issues were the rate of interest and releases.

The complexity of the British position is shown by the contrast between the cancellation hardliners, Eady's assertion that cancellation was 'difficult' and declarations by British officials of the Indian Government that 'there should and can be no scaling down of Indian sterling balances'.⁷³ The Indian Reserve Bank history for 1935-1951 just mentions that the Indian side reported that the British delegation had made no suggestion that the Financial Settlement of 1940 had been inequitable and asserted that no question would be raised about prices charged for war supplies.⁷⁴

Agreement between Britain and India on 14 August 1947, at the time of Indian independence, only involved releases of sterling balances and limits to dollar expenditures to be valid until the end of the year. Sterling balances were deemed to total £1160 million as of 14 July 1947. Two accounts were created. A working balance of £30 million was credited to no.1 account. £1095 million were credited to no.2 account. £35 million would be released until the end of 1947 of which £15 million in dollars. India

⁷¹ SAN 4th meeting in the Treasury, Sterling balances negotiations with India, 25 Jan. 1947, BoE:OV56/19, and Eady memo on Negotiations on Sterling Balances with India, Egypt, Iraq and Iran, 18 March 1947, BoE:OV56/19.

⁷² B.K. Nehru states in his memoirs that Eady abused the Indians on their intransigence and that when he urged that India 'must have a cast-iron guarantee against devaluation of sterling' Cobbold's reaction was that the Bank of England would never contemplate such guarantee as 'sterling was sterling', Nehru, *Nice guys*, p. 223. Nehru [Joint Secretary, 1947] was prominent in the decisive sterling balances negotiations of 1947-48

⁷³ Speech by Jones, 17 March 1947, Press Information Bureau Government of India, TNA:T236/114.

⁷⁴ Simha, *Reserve Bank of India*, p. 619.

agreed not to reshuffle investments so as to increase the average rate of interest on sterling balances.⁷⁵ See Table 4 for outstanding sterling balances 1945-1953.

In January 1948, a British mission led by Sir Jeremy Raisman visited Delhi to negotiate a new agreement. India wanted a release of £39 million in the first semester of 1948 of which £20 million in dollars. The Treasury resisted as India had overspent US\$92 million (£23million) in 1947, of which US\$16 million to increase the reserves of Indian banks. Negotiations were difficult and there was mention to an Indian exit of the Sterling Area.⁷⁶ Britain abstained from pressing for a refund of advances excepting those for increased bank balances.⁷⁷ A Raisman-Rao exchange of letters dated 16 February 1948 extended the former agreement until 30 June 1948 and allowed a further release of £18 million with a dollar limit of £10 million⁷⁸

Table 4

Sterling balances: India, millions of pounds and US\$ dollars 1945-1952

| | Sterling | US\$ | Adjustments in US\$ | Total adjustment | Source of adjustment |
|----------|----------|------|------------------------|---------------------|---|
| 31.3.45 | 1022* | 4119 | 0 | 0 | |
| 30.6.45 | 1138** | 4586 | 0 | 0 | |
| 31.12.45 | 1311*** | 5283 | 37.2+130.6 | 164.4 | Interest half year 1945 and gold sales |
| 31.12.46 | 1269*** | 5114 | 79.8 | 79.8 | Interest 1946 |
| 31.12.47 | 1189**** | 4792 | 74.9 | 74.9 | Interest 1947 |
| 30.6.48 | 1198**** | 4828 | | | |
| 31.12.48 | 974**** | 3925 | 63.3+180.5 | 243.8 | Interest 1947 and pension settlement |
| 31.12.49 | 822 | 2301 | 48.2+1011 | 1059.2 | Interest 1949 and devaluation |
| 31.12.50 | 804 | 2251 | 41.3 | 41.3 | Interest 1950***** |
| 31.12.51 | 730 | 2044 | 37.2 | 37.2 | Interest 1951***** |
| 31.12.52 | 694 | 1943 | 33.3 | 33.3 | Interest 1952***** |

1945-9: *Table 3 ***E.D.(W)(49)11, 8 Nov. 1949, Cabinet. Working Party on Sterling Balances, Appendices, TNA:T236/2684 ****TNA: T236/4790. For Sterling Area, non-Sterling Area and total data: *Sterling Balances since the War*, TNA: T267/29 1949-53: Schenk, *Britain and the Sterling Area*, pp; 50-3, based on BoE EID/98-106 files. *****Considering balances valued at US\$4.03/£.

Exclusion of India from the Sterling Area would run against British interests. The bulk of Indian exports to Britain and the Overseas Sterling Area consisted of essentials which could not be reduced, while Indian imports of British consumer goods could be

⁷⁵ UK, *Financial agreement* 1947. B.K. Nehru reported that Eady confided on him on the imminent sterling suspension of convertibility by warning him to 'watch your dollars', Nehru, *Nice guys*, p.228.

⁷⁶ Zachariah, 'Creativity of destruction', p. 577.

⁷⁷ India and Pakistan: Sterling Balance Negotiations, memorandum by the Chancellor, Economic Policy Committee (48), 12 March 1948, TNA:CAB 129/3.

⁷⁸ UK, India Exchange of letters 15 Feb. 1948.

significantly reduced. The Indian positive trade balance of £12 million with Britain would be increased to £41 million. With the Overseas Sterling Area as a whole an Indian deficit of £35 million would be turned into a £1 million surplus.⁷⁹

In mid-1948, K.K.S. Chetty, the Indian finance minister, visited London. His instructions made clear that India considered essential to resist scaling down and wished a rate of interest at least equal to that applying to United States and Canadian loans to the United Kingdom. The Indian war contribution should be stressed and that fair prices had been charged from Britain. It had never been clear to India that these were 'war debts'. "If sterling balance holders are singled out for maltreatment", dissociation from the sterling system might be considered.⁸⁰ Agreement was reached on 9 July 1948 on the use of £147.5 million of sterling balances to fund future payment of pensions due by the Central Government and £20.5 million due by the Provincial governments. It was also agreed that defence installations should be purchased for £100 million from which £55 million due to India on previous military expenditures would be deducted resulting in a net Indian payment of £45 million.⁸¹

Exchange guarantee played a minor role in the negotiations. The Indians raised the subject in 1944 aiming at placing India in the same position of other holders of sterling balances such as those in South America or Portugal. This was countered by the British with the argument that since India was in the Sterling Area if sterling were devalued either the rupee could follow or it would be inequitable that Indian sterling balances should be written up. The issue was raised again in the Chetty-Cripps negotiations of mid-1948 but nothing came of it.⁸²

The British had proposed releasing £70 million in 3 years and no dollar allocation. Finally agreed releases in 1948-51 amounted to a total of £80 million in equal installments on 30 June 1950 and 30 June 1951 with no releases before 1950. There was some scope for anticipating the releases. Drawing of hard currency reserves was limited to £15 million in the first year. India agreed to liberalize her policy on imports of consumer goods. The Indians had wished a release of £200 million in the three years, of which half convertible. In the end Rao extracted 1 per cent for the capitalization of pensions by mentioning to the British that if they insisted on 0.5 per cent India and

⁷⁹ Tomlinson, 'Indo-British relations', p. 155, quoting draft, undated memorandum, "India and the Sterling Area", TNA:T236/1145.

⁸⁰ Thakurdas Papers, Government of India. Ministry of Finance. Sterling balances 1. Brief for delegation, 269 Nehru Memorial and Museum Library (NMML).

⁸¹ Nehru, *Nice guys*, p. 237 states that in the last meeting dealing with stores and fixed assets Stafford Cripps [Chancellor of the Exchequer, 1947-50] asked 'what is my pourboire' before agreement on £100 million and that Cripps 'by sweet reasonableness' had partially achieved what Churchill demanded by more truculent means.

⁸² 12.4.44 Young to Waley and Catto, 12 April 1944, TNA:T236/1111 and Cobbold to Catto [Bank of England, 1944-49], 10 June 1948, BoE:OV56/22. Meade [Economic Section and Central Statistical Office] in his memo Some notes on the Indian Sterling Balances, 27 Jan. 1947 had stressed that it should be avoided 'to insert any guarantee on the value of [Indian] blocked balances', TNA:T236/1119.

Pakistan would claim capitalization at 3 per cent as used in cases of individual compensation.⁸³

The Indian review of the 1948 negotiations mentioned only that the agreed interest rate on pensions capitalization had been 'somewhat higher than that earned by sterling balances as a whole'. Chetty, in a statement to the press, avoided the subject and stated that 'the ghost of scaling down had been finally laid ...in spite of all Churchills'.⁸⁴ In a bellicose mood he mentioned that 'we had tried our best' but had been unable to extract a gold clause from the British and, in a bitter answer to Churchill's assertion that India had been saved from slaughter, said that India had saved England from being a dependency of Germany and Churchill from being Hitler's butler.⁸⁵

In the midst of a rise of Indian imports, India's spent £90 million of sterling balances in the first 9 months of 1948-9, £50 million by drawing on no. 1 account and £40 million by anticipating the 1948-9 release. A Cripps memorandum was handed to Pandit Nehru. It stressed that this pace could not be maintained, proposed a tapering off of Indian drawings and mentioned difficulties surrounding the supply of capital goods.⁸⁶ The Indian answer was very angry as Mathai, the new Finance minister, thought the British inconsiderate for delaying a negative answer to Indian wishes for ten weeks and thus allowing further Indian drawings. The British were on the defensive and decided not to answer in the same 'belligerent tone'. Crucially, it was decided 'to depart from the idea that releases have been in anticipation of those agreed for the future'.⁸⁷

In August 1949, Harold Wilson, President of the Board of Trade, and Krishna Menon, Indian High Commissioner in London, signed a new agreement covering £81 million of advanced releases and defining releases of £50 million in 1949-50 and £50 million in 1950-1.⁸⁸ The 'obnoxious dollar ration was done away with'.⁸⁹ The London press

⁸³ UK, *India Exchange of letters...* 9 July 1948. Eady pointed out in early 1948 that to give India a hard currency ration was equivalent to have India outside the sterling area 'without the political or strategic consequences of a formal expulsion or an indignant departure' as quoted by Tomlinson, *Indo-British relations*, pp. 161-2. The net Indian wartime contribution to the Dollar Pool had been of Rs. 114 crores (£85.5 million) but the balance became negative after the war, Press Note, Government of India, Sterling balances talks, section 7, 14 Jan. 1947, BoE:OV56/19; Thakurdas Papers, Government of India, Ministry of Finance, Brief for delegation, NMML; memo, Conversation Wilson Smith-Rao, 9 June 1948, TNA:T236/1144; Note on decisions reached by Cripps and Chetty, 24 June 1948, and Wilson Smith (?) to Trend, 24 June 1948, TNA:T236/1145.

⁸⁴ [Chetty] *Sterling balances*, Thakurdas Papers 381 NMML and *The Statesman*, 14 Aug. 1948.

⁸⁵ *The Statesman*, 14 Aug. 1948.

⁸⁶ Memo on Rate of expenditure of India's sterling balances, enclosed to Rowan [Second Secretary, H.M. Treasury] to Cripps, 21 April 1949, TNA:T236/4412 and Turnbull [Private Secretary to the Secretary of State for India] to Rowe-Dutton, 21 Jan. 1948. India Office. L/E/9/303.

⁸⁷ India's Import Policy TNC ON (49) 154, 4 May 1949, and tel. 1576 CRO to High Commission India 14 May 1949, TNA:T238/59.

⁸⁸ UK, *Financial agreement [with] Egyptian government*, 31 March 1949.

⁸⁹ Balachandran, *Reserve Bank*, p.601. Indians were extremely critical of the 'dollar ration' as made clear by B.K. Nehru: 'the British had been so extraordinarily nasty in allowing us to draw from the dollar pool', Nehru, *Nice guys*, p. 261.

condemned the extravagance in British releases and the government's contention that India was a special case.⁹⁰

The British remained concerned about the rising trend of the average interest rate on sterling balances as the Indians made large payments such as those on the capitalization of pensions by liquidating Treasury bills. The average interest rate was 0.8 per cent by the end of March 1948 and rose to 1.073 per cent in August 1949 as the share of bills in total balances fell from 78.3 to 60 per cent. It was deemed important to convince the Indians to move from bonds on maturity to bills but in July 1949 the two governments agreed not to renew the understanding on maximum interest rate established in 1947.⁹¹

Addressing the Commons on the Wilson-Menon agreement of 1949, Attlee was ambiguous on the desired final outcome of the matter. It was 'quite impossible that we should pay all these sterling balances' and 'eventually there must come a settlement of all these things'. But we 'cannot disregard the rights of other people' and 'repudiate them at this time'.⁹²

When Hugh Gaitskell, the Chancellor of the Exchequer, reported in the Commons in late 1950 on the preliminary talks with India, Pakistan, and Ceylon on the Colombo Plan for Cooperative Economic Development in South and South-East Asia, he was met by criticism from the opposition. Churchill stated once again that a counterclaim should be entered in relation to India and a bitter, rather personal exchange followed.⁹³

The new Conservative government exchanged letters with India in February 1952 on a final agreement on sterling balances on which negotiations had been started under the previous Labour government. It was a 6-year agreement up to 30 June 1957 in the framework of the Colombo Plan. It provided for the immediate transfer from no. 2 account to no. 1 account of £310 million to constitute a currency reserve not be drawn down except in consultation with the British Government. Yearly transfers of £35 million/year for 6 years from no. 2 to no. 1 account were also agreed upon.⁹⁴

V

Releases of sterling balances were agreed from time to time between 1947 and mid-1951 totaling £815 million, excluding transfers to Pakistan under the partition arrangements (see below) and the constitution of a currency reserve in London in 1952. Of the total, £168 million were related to pensions owed to the Government of India and provincial civil servants and £54 million for the purchase of military stores. The remaining £593

⁹⁰ *The Economist*, 3 Sept. 1949.

⁹¹ Minute, ? to Haslam (Bank of England), 24 Aug. 1949, TNA:T236/4279 and Balachandran, *Reserve Bank*, p. 601. Deshmukh, *Economic developments*, pp.118-9, refers -- not dissatisfied -- to the increase from 0.5% to 0.8% (well aware that securities in Britain were earning 2.5-3%).

⁹² Speech by Attlee, 27 Oct.1949, in *Hansard* (Commons), 27 Oct. 1949 cols. 1529-643.

⁹³ *Hansard* (Commons) 7 Dec.1950, cols. 540-4.

⁹⁴ Terms of the 1952 agreement were confirmed by the agreement signed in July 1953, UK, *Consolidating the Financial Agreement of 14 August 1947*.

million involved releases to be spent by India mostly on imports from the United Kingdom (see Table 5).

There were intricate negotiations following the decision on the partition of British India into the new Dominions of India and Pakistan. Sterling balances held by the Reserve Bank of India were shared. The share of Pakistan of the Banking Department of the Reserve Bank of India assets and liabilities amounted to £75.6 million which were transferred in early July 1948. Transfers of sterling securities held by the Issue Department of the Reserve Bank of India amounted to £73 million and were mostly effected between September 1948 and March 1949. Overall transfers to Pakistan up to mid-1949 had amounted to £180 million.⁹⁵

Table 5

India: Sterling releases post-independence, 1947-1956, £ million*

| | Working balance and general | Special purposes | Total |
|------------------------|-----------------------------|------------------|-------|
| 14.8.1947-31.12.1947** | 65 | 18 | 83 |
| 15.2.1948** | 18 | 15 | 33 |
| 9.7.1948** | 81 | 248*** | 329 |
| 1.7.49-30.6.1950 | 110**** | | 110 |
| 1.7.50-30.6.51 | 50**** | | 50 |
| 1951 | 35 | | 35 |
| 1952-1956 | 175 | | 175 |
| Total | 534 | 281 | 815 |

*Excluding transfers to Pakistan under partition agreements of the order of £180 million and £310 million to constitute a currency reserve held by the Reserve Bank of India **British India. *** Of which pensions £168 million and stores £54 million. **** Conditional on need.

Source: Cabinet. Working party on Sterling Balances E.D. (W) (49) 11, 4. Nov., Appendices p. 7, TNA: T236/2684 and UK, Exchange of letters 8 Feb. 1952.

By early 1943 the India Office had raised the issue of the interest rate that should be applied to the capitalization of pensions due by the Dominion to civilian and military personnel serving in India before independence. It was thought that something better than the 2.25 percent applied to the Railway Annuities could be arranged and sought the Government of India's approval to negotiate with the British Treasury aiming at no less than 2.25 per cent. The Government of India and the Reserve Bank thought that there was a good case for 3 per cent but agreed to an absolute minimum of 2 per cent. High British Treasury officials were still considering in early 1943 that the pensions should be capitalized at 3 per cent: 'the average period of our annual payments under the [pension] plan would be about twenty-eight years, and as this is the same as the period of the 3% Savings Bonds now on tap, we should pay 3 percent'⁹⁶

⁹⁵Simha, *Reserve Bank of India*, pp. 567-8). Note by the Treasury, ON (49) 199, 7 June 1949, TNA:T238/59. For details on sterling balances and partition, Simha, *Reserve Bank*, ch. 18.

⁹⁶Eady to Norman [Governor, Bank of England], 16 Jan. 1943, BoE:G1/309.

The British official history pointed out that the proposals circulated in 1943 carried terms that might seriously prejudice the rate of interest question in further adjustments of sterling indebtedness. 'The 3% basis taken as reflecting current Treasury borrowing terms for the "weighted average period of the annuities", was quite inconsistent with the idea of post-war settlement that Lord Keynes...was now propagating in the Treasury'.⁹⁷

By mid-1943 Keynes proposed that the Indian pension fund should carry no interest.⁹⁸ Catto, from the Bank of England, was more explicit. Since at zero interest rate payments amounted to £295 million which discounted at 3 per cent would correspond to a present value of £150 million that would be equivalent to £145 million, 'a very good way of wrapping up a war contribution' by India.⁹⁹ The India Office, on the other hand, as late as 1945 was still envisaging to discount the pensions at 3 per cent.¹⁰⁰ The British stressed that arrangements for the transfer of Britain's obligations should not be a condition precedent to independence but there was a thinly veiled implicit menace: 'after all we hold a good security in form of London balances'.¹⁰¹

While there was much discussion before 1948 of the details that should apply to the payment of pensions that would be eventually capitalized against payment of a lump sum out of sterling balances, views on the coverage of such pensions tended to converge and the crucial outstanding issue was the interest rate to be used. In July 1947 the leaders of the parties in the Government of India 'guaranteed the existing terms and conditions of service of all their employees including Europeans'.¹⁰² The Indians in 1948 still hoped to obtain 3 per cent.¹⁰³ But the British had made their minds that 'we [can] not prejudice our claim to a low rate of interest on [the balances] by agreeing to pay a higher rate (say 3%) in respect of the pensions'.¹⁰⁴

As late as 1948 it was feared in London that 'the Indians are likely to claim that pensions should be capitalized at the market rate of interest. They have a strong lever in the fact that they have power, in theory at any rate, to make a rule requiring all officers to commute their pensions at 3%. This would in practice have the effect of capitalizing

⁹⁷ Sayers, *Financial policy*, p.262. Total payments amounted to £297 million over 75 years with a present value of £150 million with an implied interest rate of about 3%.

⁹⁸ Memo to Eady, "The problem of India's sterling balances", 10 Aug. 1943, Keynes, *War finance*, p.340.

⁹⁹ Catto's memo on India's Sterling Balances, 13 Sept. 1943, TNA:T236/148.

¹⁰⁰ Bridges's memo, 8 March 1946, TNA:T236/1113: 'we rejected this, on the ground that we were not prepared to borrow from India at 3%'.
¹⁰¹ Casey [Governor of Bengal] to Colville [Acting Governor-General of India], telegram 274, 1 Sept. 1945, Most immediate Secret, Addressed to Viceroy, #83, Mansergh and Moon, *Post-war phase*.

¹⁰² Record of Meeting of Special Committee of the Indian Cabinet, 7 July 1947, #546, Mansergh et al, *Mountbatten Viceroyalty*. Dalton had been insisting that 'if the Indians refused to pay compensation for Members of Indian Services appointed by the Secretary of State and for Officers of the Indian fighting Services .. it should be made clear to them that this matter would have to be taken into account in future discussions on sterling balances', Cabinet. India and Burma Committee 113 (47) 14th meeting, 23.47, #529, Mansergh et al, *Fixing a time-limit*.

¹⁰³ Thakurdas Papers, file 269, Government of India. Ministry of Finance Sterling Balances Document H, 14 May 1948, NMML.

¹⁰⁴ Draft Cabinet. ONC note, India and Pakistan, , 1 April 1948, TNA:T236/1142.

pensions at 3%'.¹⁰⁵ It was Rao who in April 1948 opened the way for agreement on a rate as low as 1 per cent mentioning that he was trying to convince his colleagues.¹⁰⁶

In the Chetty-Cripps negotiations of August 1948 it was agreed that central government pensions would be capitalized at £147.6 million and provincial pensions at £20.5 million. The implied rate of interest was 0.95 per cent.¹⁰⁷ If discounted at 3 per cent the nominal payments for both central and provincial government pensions would amount to £123.3 million contrasted with the £168.1 million actually paid. It was not the £145 million gain envisaged by Keynes and Cobbold, but £44.8 million was substantial.¹⁰⁸ Capitalization of pensions was opposed without success by Indian business interests claiming that pensions had been safeguarded by the 1935 Government of India Act.¹⁰⁹

Payment related to stores and military installations was uncontroversial. Their book value was £375 million but London agreed that £100 million should be regarded a reasonable compensation. There was no concealed cancellation and the issue was agreed upon peacefully.¹¹⁰

As early as mid-1942 London had considered the possibility of using the sterling balances to purchase privately owned British assets but the alternative was rejected as, 'apart from our natural and legitimate reluctance', the issue was complex, especially concerning valuation.¹¹¹ By late 1944 there were still illusions in British business circles that Anglo-Indian joint ventures would play an important role in the reduction of sterling balances as the Indians would 'regard a share in the P. & O. or I.C.I. as admission into the very *arcana imperii*'.¹¹² These hopes did not materialize.

The sale of British assets in India would have played a minor role in disposing of sterling balances. Indian estimates of British investment in India were much above those considered reliable in London.¹¹³ Discrepancies were explained by differences in

¹⁰⁵ Turnbull's minute, May 1948 ?, India Office L/E/9/316.

¹⁰⁶ Tel. 1170 REMAC, United Kingdom High Commission in India to CRO, 29 April 1948, TNA:T236/1152.

¹⁰⁷ IPN 6, Indian and Pakistan negotiations. Record of first discussion between ministers, 7 June 1948, BoE:OV56/22.

¹⁰⁸ Indian pensioners could commute their pensions at 3%, Delegation brief no. 13, India and Pakistan Negotiations. Rate of interest, 15 May 1949, TNA:T236/4279..

¹⁰⁹ Mukherjee, 'Indo-British finance', p. 248.

¹¹⁰ IPN5, Indian and Pakistan negotiations. Report to the Chancellor of the Exchequer, 7 June 1948, BoE::OV56/22; Reserve Bank of India, *Report... 1948-49*, p.92 and Government of India. Ministry of Finance. Brief for delegation, ? 1948, Takurda Papers, NMML..

¹¹¹ Memorandum on Indian Sterling Funds, 24 July. 1942, BoE: G1/309.

¹¹² Memo on Sterling balances and the association of British and Indian businesses, December 1944, TNA:T236/1112. Indian private sector pressures that sterling balances should be used to take over British business interests were strong, Record of Meeting of Deputation representatives of U.K. Business Interests in India and U.K. Trade with India with Lord Pethick-Lawrence and others, 14 March 1946, #534, Mansergh and Moon, *Post-war phase*.

¹¹³ *Eastern Economist*, 26 Oct. 1945 and 16 Nov. 1945, estimated that total British investments were £2,237.26 million. Joshi memo, 18 Jan. 1946, TNA:T236/1113 estimated these as in the region of £900-1,100 million. There were reports of pressure by Indian capitalists that sterling balances should be used to

coverage and the repatriation of British investment between 1942 and 1948. British investments in July 1947 are unlikely to have exceeded £250 million.¹¹⁴ In any case, the British government was against such use of sterling balances as the sale of investments in India would imply a foregone return of at least 3 per cent.¹¹⁵

As part of the attempt to reduce inflationary pressures in India the British sold £77 million of gold in India during the war consequently reducing sterling balances.¹¹⁶ The Bank of England feared that this could whet the Indian appetite for gold with an undesirable impact on central reserve of the Sterling Area. Moreover it would have 'as much effect in the Indian market as a pea-shooter would have on an elephant'. But it was a very profitable operation as gold was sold above £15/ounce and obtained in South Africa at £8/13/7.¹¹⁷ The India Office suggested, to no avail, that profits should accrue to India. Keynes argued that this was the sale of a commodity 'which happens to be our gold' and that India was 'already profiteering out of the war unduly'. 'If the Secretary of State [for India] on his own initiative tries to interfere with this very mild offsetting measure, the Chancellor of the Exchequer will use his influence with the Prime Minister to have the Secretary of State hung, drawn and quartered'.¹¹⁸

VI

Indian wartime inflation was substantial: on average 18.1 per cent, with a peak of almost 70 per cent in 1942-43. There was much criticism in the Treasury in London on how the acceleration of Indian inflation had been allowed to occur. Worries in the Treasury early in the war about the danger of rising inflation had been met by comments from the government of India such as 'you don't understand conditions in India. It cannot happen here.' The Treasury thought that 'the charge of sin against India [is] not that she has failed to do what we have done but that she has done three years too late what we have done (and thus show what she could have done)'.¹¹⁹ Later in the decade, however, the British had come to the conclusion that there were severe limitations to inflation control through the flotation of rupee loans as the market had shown itself to be unable to absorb additional loans. The only alternative was financing through expansion of the money

buy British investments earning more than 10 per cent rather than the 0.5 per cent paid on sterling balances, Mukherjee, 'Indo-British finance', p. 244.

¹¹⁴ Obtained by combining the Rs 243.49 crores Reserve Bank of India estimate for 1948 as reported by Tomlinson, 'British business in India', p.116 and the 1947-48 repatriation of Rs. 100 crores estimated by Kidron, *Foreign investments*, p.44. The Bank of England estimated a book value of £150 million in 1948, Brief 14, United Kingdom Investments in India, 29 May 1948, TNA:T236/1143. Deshmukh, *Economic developments*, p. 116, refers to the 'wild expectations' that the eventual confiscation of British investments in India would serve as a deterrent to the unilateral scaling down of sterling balances.

¹¹⁵ Rowe-Dutton to Eady, 17 Aug. 1945, TNA:T236/1112.

¹¹⁶ Harri [Chief Economic Adviser, G.H.Q. Middle East] originated the proposals, see Moggridge, *Economic policy*, footnote 39. Sayers, *Financial policy*, p. 270, is the source for the £77 million, in contrast to £73 million as in Table 2.

¹¹⁷ Sayers, *Financial policy*, South Africa pressed for a share to no avail, pp. 267, 269 and 270.

¹¹⁸ India and gold profit, 7 July 1943, Keynes, *External war finance*, p. 336.

¹¹⁹ Young's draft letter to Amery, 26 Nov. 1944 TNA: T236/1111.

supply.¹²⁰ The British official history noted that Indian inflation, which had been kept under control in 1939-41, had soared in 1942-3, but that it was a result of relatively low controlled prices of military supplies combined with prices which reflected food supply difficulties such as those which caused the Bengal famine. This situation, of course, resulted in increased costs of military supplies and so was partly responsible for the rapid increase of sterling balances.¹²¹

Wartime inflation was also substantial in other major sterling balance holders: on average 11-12 per cent in Argentina, Brazil and Portugal with peaks in different years of the war. Inflation control in these large sterling balance holders was much more difficult than in Britain, a point that took time to be grasped in London.

Wartime taxation covered about 37 per cent of total Government of India outlays in 1939/40-1945/46 while borrowing covered 27 per cent. On a year to year basis taxation covered almost all outlays in 1939/40 but fell to only 26.5 per cent in 1942/43 and improved very slowly to reach 40.3 per cent in 1945/46. The contribution of borrowing contribution to finance outlays was more erratic: 26.3 per cent in 1940/41, -12.1 per cent in 1941/2, 21.6 per cent in 1942/3, slowly increasing to reach 47.2 per cent in 1945/6. Taxation and borrowing combined fell to less than 30 per cent of outlays in 1941/2 increasing to about half of total outlays in 1942/3 and 1943/4 to slowly recover in the last war years.¹²²

Indian fiscal policies were considerably less restrained than those of other sterling balance holders and reflected the significant military expenditures: government outlays not covered by revenue or public debt increase were on average 7.4 per cent of GDP between 1939 and 1945 compared with 3.5 per cent in Argentina, 1.5 per cent in Brazil and 1 per cent in Portugal. Even taking into account borrowing this rose in India to 4.7 per cent of GDP on average and more than 8 per cent between 1941/42 and 1943/44.¹²³ Such stance on fiscal policy was not accompanied by a particularly good growth performance. India's GDP growth of 2 per cent yearly was below growth rates in Brazil and Argentina, where GDP increased 3.2 per cent and 2.6 per cent yearly in 1939-45. But the Portuguese economy stagnated, growing only 0.2 per cent yearly..

Money supply expanded at high rates in India -- almost 30 per cent yearly in 1939-45 -- compared to roughly 16 per cent in Argentina, 20 per cent in Brazil and 23 per cent in Portugal. It peaked at 68 per cent in 1942. But the pressure exerted by sterling balance accumulation was much stronger than in other sterling balance holders. The ratio between

¹²⁰ The British were worried on how to react to a possible Indian argument that India had to raise 3% domestic loans to purchase military supplies for Britain and was receiving a rate of interest not much above 0.5 per cent on the sterling balances. Delegation brief 13, 15 May 1949, TNA: T236/4279. There seems to be no record that this was raised by the Indian delegation.

¹²¹ Sayers, *Financial policy*, pp. 255-6.

¹²² Tomlinson, *Economy of modern India*, pp. 135-6, Sinha and Khera, *Indian war economy*, pp. 351-2 and Appendix XXXII. Taxation covered 53.5 per cent of total government outlays (including provincial governments) and borrowing 23.1 per cent.

¹²³ See Kamthakar, 'Different war dance', pp. 199 ff. on the difficulties surrounding taxation in wartime India.

variations of sterling balances and variations of money supply was extremely high in India between 1941/2 and 1944/5: never much below 50 per cent in 1942/3, beyond 80 per cent in all other years, and above 100 per cent after 1943/4. By comparison such ratios in other large sterling balance holders remained between 36.3 and 56.3 per cent in Portugal in the same period, only reached around 40 per cent in 1943 and afterwards in Argentina and were much lower in Brazil. There were some grounds to back the Indian counter argument of the British claim that increasing sterling balances were due to excessive prices charged in India. The Indian negotiators in 1948 reversed the causality, arguing that 'the accumulation [of sterling balances] is not the result of high prices; it is rather that the high prices have followed the abnormal purchases.'¹²⁴

VII

In spite of strong pressure by London, both before and after Indian independence, there was no outright cancellation of the outstanding sterling balances. But these balances were significantly affected by a combination of decisions both during and after the war.

In the case of several sterling balance holders the purchase of British assets -- especially railways --- played a crucial role in the liquidation of balances. The relatively modest stock value of British investments in India coupled with London's resistance blocked even a partial solution along these lines in India. There were similar difficulties in other creditors. The limited stock of foreign direct investment similarly constrained the Anglo-Portuguese negotiations and resulted in a long-term Portuguese loan to Britain.¹²⁵

As other holders of sterling balances, India was adversely affected by the gap between the rate of interest actually paid by Britain on the sterling balances and what could be considered a normal rate of interest. In computing the foregone interest several assumptions have been made, in all cases tending to reduce the computed losses. The end of the war has been assumed as the origin for estimates of the impact of adjustments. A provision of £300 million corresponding to normal Indian currency reserve has been in all cases deducted from total outstanding balances. A rough estimate of the foregone interest due to the difference between interest paid on Indian outstanding balances and the normal rates in London would be in the region of £40 million or US\$160 million. Somewhat artificially, the end of the history has been set in 1952 as a consequence of the agreement to transfer £310 million to constitute a currency reserve and yearly releases of £35 million for 6 years. Additional adjustment costs taking into account 1953-1957 in any case would only add some £12 million to the total.

In the case of India several alternative negotiations opened other opportunities for British attempts at 'concealed cancellation', as mentioned in the previous sections. During the war Britain had sold gold in India at more than £15 an ounce, a substantial wedge in

¹²⁴ Government of India. Ministry of Finance. Sterling Balances. Brief for Delegation p. 10, Thakurdas papers, NMML.

¹²⁵ On Portugal, Abreu, 'Blank cheque'. Evaluation of the impact of the sale of British assets as in the case of Argentina and Brazil is difficult as it depends on how fairly sale prices reflected the anticipated stream of profits. See Fodor, 'Argentina's nationalism', pp. 45-7.

comparison with the purchase price in South Africa which generated profits of £32.4 million. If Indian pensions had been discounted at 3% payments for both central government and provincial pensions the present value would amount to £123.3 million contrasted with the £168.1 million actually paid. India lost £44.8 million. The settlement involving military stores and installations was reasonable and did not include elements of concealed cancellation. Table 4 above includes in the three columns to the right estimates of the reduction of outstanding balances involved in different types of adjustment.

By far the most important Indian loss related to sterling balances was due to the impact of the 1949 devaluation of sterling. As a member of the Sterling Area Indian balances were not protected by a devaluation clause as many other sterling balance holders. The full compensation entailed by a devaluation clause similar to that included in the agreements of Argentina, Brazil and Portugal, all non-members of the Sterling Area, would have been of £361 million, equivalent to US\$1011 million at the new exchange rate of US\$2.80/£.¹²⁶

If the adjustment estimates included are discounted to the end of 1947 at 3 per cent the total would be US\$ 1666 million, a reduction of 31.5 per cent of outstanding balances in relation to their end of year peak of US\$5283 million in 1945. In the end the expectations of British civil servants on the result of a combination of low interest rates and delaying releases as being equivalent to significant cancellation were confirmed in tortuous way. Otto Clarke was quite near the mark but his forecast was made without anticipating the 1949 sterling devaluation which answered for almost 60% of the overall adjustment.

Compared with India, the foregone payments in the case of holders such as Argentina and Brazil were much more limited, not only because the sterling balances were much smaller but it was also possible to reduce them more rapidly. Argentina's balances were used in 1948 to pay for the British railways and by the end of 1951 Brazilian balances had disappeared. Foregone interest payments were unlikely to have exceeded £6 million (4 per cent of their peak value) and £7 million (10 per cent of their peak value), respectively. In the case of Portugal, however, the foregone interest payments were substantial as mid-1945 balances were mainly settled with a loan to Britain carrying an interest rate of 0.875 per cent which was only paid up in 1973. Foregone interest amounted to about £24.3 million discounted to the end of 1947, or 40 per cent of the outstanding balances. But Portuguese balances were protected by a gold clause so they were adjusted in 1949 and 1967 to take into account sterling devaluations,. These two credits discounted to 1947 amounted to £26.4 million more than compensating the foregone interest payments.

All these evaluations have been undertaken in current pounds sterling or US\$ dollars. But if the focus of the analysis turns to the consequences of delayed releases on the level of imports the sizeable equivalent cancellation of 31.5 per cent of outstanding Indian balances turns out to be a serious underestimation of the such "adjustments". India was seeking to use a significant share of the balances for "capital development" purposes so the evolution of prices of capital goods is crucial to put into perspective the costs entailed

¹²⁶ The other country significantly affected by sterling devaluation against the the US dollar was Egypt,

by the delay in releasing the balances. Between 1945 and 1952 the relevant prices in Britain (iron and steel manufactures) practically doubled.¹²⁷

It has been suggested that India somehow squandered her sterling balances in buying pension annuities, imports of consumer goods and purchasing British-owned assets.¹²⁸ Contrary to some views sterling balances were not used to buy out British owned assets. There was a lot of pressure from Indian entrepreneurs, but the British direct investment stock was too limited if compared with the outstanding sterling balances. While the settlement of pensions was politically controversial and the use of a very low interest rate was detrimental to Indian interests, it is rather more difficult to question the use of released sterling to purchase imports. India import volumes only recovered the 1938-39 level in 1949-50 with a GDP about 10 per cent higher.¹²⁹ And as noted by the official history of the Reserve Bank of India 1951-67, there were strong incentives to spend the balances induced by fears concerning sterling stability.¹³⁰

Of all the issues discussed by British and Indian negotiators the pensions settlement was the one that would possibly offer scope for improvement of the terms finally reached. From a radical viewpoint, it would even have been possible to question whether India was liable. But there was room to improve the finally agreed terms. There were no good British arguments to be intransigent on this as shown by the agreed interest rate of around 1 per cent in contrast with the 0.5 per cent which became the target after the Keynes no interest policy proved to be not feasible politically. But even if the British had agreed to a 3% interest rate to discount the pensions this would make little difference for the overall outcome of the negotiations.

That India was by far the less favourably treated of all sterling balance holders, with the possible exception of Egypt, was to a large extent unavoidable. C.D. Deshmukh's comments made in the mid 1950s were unduly optimistic on the outcome of negotiations, but reflected the sentiment that it would be very difficult to improve their outcome: "I should think that, on the whole, the terms and execution of the various sterling agreements regarding the release of the balances and the conversion of these amounts into non-sterling currencies have not been unduly inconvenient to us; in fact the entire relationship has been maintained without turbulence and trouble and with a well-balanced sense of accommodation".¹³¹

The more radical measures considered by New Delhi to have access to scarce dollars, such as to abandon the Sterling Area, would not have solved the crucial weakness of the

¹²⁷ Board of Trade Wholesale Prices Indices, Iron and steel, Mitchell and Jones, *Abstract of statistics*, p. 188.

¹²⁸ Desai, 'Drains, hoards and foreigners', p. 11.

¹²⁹ British export prices increased sharply during the war. In 1943 they were 47% above the 1938 level and 60% above the 1939 level. This was in line with United States export prices. United Kingdom, *Statistical digest*, p. 162 and Carter et al, *Historical Statistics of the United States*, 5-518. Indian import prices doubled between 1938/9 and 1945/6, rose a further 47% until 1947/8 and 18% more in 1948/9. Import volume only reached the prewar level in 1948/9, India, *Statistical Abstract* 1953.

¹³⁰ Balachandran, *Reserve Bank of India*, p. 605.

¹³¹ Deshmukh, *Economic developments*, p.118.

Indian position which was the absence of a protection of the Indian sterling balances from the consequences of sterling devaluation. But that there was no outright British counterclaim and unilateral cancellation can be considered the main Indian victory. The combination of cancellation, disguised cancellation and the 1949 devaluation would have been disastrous.

It is always tempting to guess what would have been the outcome of the negotiations in case they had not coincided with Indian independence. But such a counterfactual is too complex to allow a simple answer. What can be said is that India paid a heavy price to reach an agreement on the sterling balances issue but perhaps the sacrifice was made easier amidst the exhilaration with independence and its "tryst with destiny".

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