company was allowed, 'on sufferance to continue a somewhat maimed existence' (Irwin to Birkenhead, 31 May 1928, Pvt. Letter, Halifax Papers, 4). As the restrictive terms of this agreement came to be generally known political agitation for the reservation of passenger and cargo traffic on the Indian coast gained strength. In 1928, S.N. Haji proposed a coastal reservation bill. But Inchcape was influential enough to scuttle the attempt of 'Bombay financiers . . . to drive British enterprise out of the country'; he urged Birkenhead: 'Do put your foot down the way you alone can do it' (Inchcape to Birkenhead, 3 Aug. 1928, encl. with Birkenhead to Irwin, 7 Aug. 1928, Ibid) Birkenhead did: 'I . . . regard the proposal', he wrote to the Viceroy, 'to exclude British shipping from this trade as monstrous' (Birkenhead to Irwin, 13 Sept. 1928, Ibid.) In 1933 when the earlier agreement came to an end political pressure was greater and Inchcape was no more. Meanwhile, Japanese competition had become a great threat to B.I.S.N. Co. Scindia used this opportunity to gain slightly better terms and this agreement was given stability by the non-discrimination clause (Article 115 in the Act of 1935) specifically to protect British shipping.

88. See E.C. Benthall's Diary, 1929-33, entries of 7, 8 June 1930; Benthall to Godfrey, 17 Dec. 1930. Benthall Papers, VIII, VII.

89. Cf. D.C. Potter, 'Manpower Shortage and the End of Colonialism: The Case of the Indian Civil Service', *MAS*, VII, 1 (1973), pp. 48-73. It was only after the outbreak of the Second World War that the Civil Service finally began to change its colour. Writing about the dominant mentality amongst Anglo-Indians in the 1930s, Denis Kincaid commented that despite the changed times, 'it is extremely unlikely that any one will ever mistake them for citizens of any nation but their own'. *British Social Life*, p. 292.

CHAPTER 2

Britain, India and the World Economy: 1919-1939

In the nineteenth century, as colonial rule began to take its modern form, India became an asset of growing value to Britain—commercially, financially, militarily and psychologically.[1] Dominion over India increasingly appeared to make all the difference between Britain being a 'first rate and a third rate power', and she seemed 'determined as long as the sun shines in heaven to hold India'.[2] For, as Lord Mayo put it, 'Our national character, our commerce, demand it and we have one way or another, 250 million of English capital fixed in the country'.[3] In 1913 India was Britain's largest market, taking 16 per cent of all British exports; she was of course the greatest market for Britain's most important industry—cotton textiles. Britain was also the largest supplier of industrial goods to India, and controlled virtually the entire invisible trade of India. On the other hand, although Britain was the single largest purchaser of Indian primary goods, up to 1913 the bulk of Indian exports went to other, mainly non-empire, countries. This pattern suited Britain eminently. India's trade surplus with the rest of the world and her deficit with Britain on both visible and invisible accounts helped Britain finance two-fifths of her deficit with Europe and America.[4] The policy of free-trade in India secured the latter's crucial place in the system of Britain's international settlements; it kept India open for British goods at a time when other markets were closing against her and also prevented retaliation against Indian exports which could lead to loss of her hard currency earnings.[5]

Despite professions of laissez-faire, Britain used her dominion over India to intervene actively in the economy to ensure the free flow of her goods, to promote the development of India as a producer of raw materials, to encourage the foreign-trade sector, and to make India a safe field for British investment.[6] In 1913 India was the fifth largest area of British investment and the third largest within the empire, such

investment being concentrated largely in government loans, railways, plantations and extractive industries.[7] Up to 1914 British expatriates overwhelmingly dominated the modern industrial sector, as well as foreign trade, banking and shipping.

India provided 'honourable and liberal employment' to large numbers of Englishmen in government offices and commercial enterprises. Conversely, Indian human resources were used by Britain both for her military purposes and as an exportable supply of cheap and mobile labour. Indian revenues paid for a huge army; Indian indentured labour contributed to the overseas wealth of the empire.[8]

On the eve of the Great War, then, India was unquestionably imperial Britain's most prized possession. But Britain's system of power and profit in India was not immutable. Any change in one major variable—be it the pattern of international trade and investments, the demand for India's primary products, the international competitiveness of British exports, a strain on imperial finances or pressure on the ratio of the rupee to the sterling—could throw into jeopardy India's key role for British commerce and finance and in the multilateral network of settlements which sustained Britain's prosperity. Moreover, the quiet enjoyment of the signal benefits of the Indian empire could be interrupted by forces, whether internal or external, that could disturb the political peace of the realm and threaten the security of the Raj. Already as we shall see, there were awkward signs of Britain's declining industrial and commercial power in a far from stable world economy. And while international political circumstances, however amenable to British diplomacy they might have proved hitherto, could scarcely be taken for granted, in India politics had begun to develop in directions which could defy the Raj's style of opposition management and self-preservation.

The First World War and subsequent developments in the following two decades brought the vulnerabilities of Britain's world system sharply into focus. The War accentuated many of the trends that were already operating to undermine the international economy as it existed in 1913. Much to Britain's discomfort, it never recovered from the shocks delivered by the War, and with the onset of the Great Depression it finally broke down. This forced Britain to turn to her empire to bail her out of difficulties as she struggled to minimize the traumas of slow structural adaptation of her domestic economy to dramatic global changes. Inevitably, these developments underlined the continued, if changing, value of India in Britain's imperial scheme. But before we deal with

this, we need to review the changes in the international economy and Britain's relationship to it during the years between the Wars.

Britain, Empire and the International Economy

In 1913 Britain held a central position in the international economy, with London at the hub of international finance and commerce, and sterling unquestionably secure in the world. Yet not all was well beneath this apparent prosperity. For at least four decades, cracks had begun to weaken the foundations of British economic supremacy.

In the second half of the nineteenth century industrialization, especially in Western Europe and the USA, proceeded apace, and by 1913 the share of Britain in world manufacturing declined from two-thirds of the combined share of France, Germany, and the USA in 1870 to less than one-fourth.[9] This, accompanied by an increase in tariff protection overseas, naturally affected the growth rate of British exports. Not only was the volume of Britain's exports growing at a decreasing rate compared to her earlier performance and the performance of her competitors, but more significantly her share of the world market for manufactured goods was shrinking. In the 1850s Britain's share in world exports stood at 40 per cent; by 1900 it had declined to 28 per cent, threatening her export-dependent prosperity.[10] Imports, meanwhile, were growing more rapidly than exports, and from 1870 foreign competition in manufactured goods began to make its presence felt in Britain's domestic market as well. The failure of British manufactures to retain their lead over international competition indicated deteriorating economic performance. The growth rate of industrial productivity declined sharply from the 1880s after twenty years of stability, and factor productivity increased at a very slow rate from the last decade of the century up to the outbreak of the First World War. Overall, the fifty years before the War was a period of poor industrial performance, reflecting a low rate of structural change of British industry in favour of high productivity sectors and a slowdown in technical progress.[11]

From around the turn of the century Britain's emerging problems were further compounded by a fundamental change in the commodity composition of world trade in favour of commodities in whose production Britain's main competitors had already forged far ahead.[12] With a faltering domestic economy and an increasingly hostile international environment, Joseph Chamberlain's movement for protecting British industry and commerce within a closely integrated empire economic bloc gathered force in the early years of the twentieth century. But other

developments in the international economy allowed Britain to prosper while remaining committed to unadulterated free-trade. For, while it was true that her share in world manufactured exports continued to fall between 1900 and 1913 (because of Britain's higher relative export prices and her inability to enter new export lines),[13] the rate of growth of her exports revived owing to a remarkable rise in capital exports and favourable movements in the terms of trade for primary producing countries. She was thus able to divert her staple goods (which constituted the greater portion of her export trade) to these non-industrialized countries, most notably within the empire, but also outside it. Significantly, the proportion of cotton goods entering world trade was declining as Europe, the USA and Brazil supplied their own requirements. But after 1900 rising incomes in primary producing countries, especially in India, more than offset the loss of trade through increasing self-sufficiency.[14] This convenient diversion of British exports was accompanied by the growth of the system of multilateral settlements and the emerging complex network of relations among the primary producers within the empire, the newly industrializing nations of continental Europe, the USA, and Britain. The exports of primary products from the empire to the emerging industrial economies were instrumental in providing surpluses which Britain was able to channelize in order to meet her trade deficits vis-a-vis the USA and Western Europe. An important factor in the development of multilateralism was the flow of British capital along with the associated services of the financial institutions and the 'invisibles' sector based in London. The massive earnings from the returns on overseas investment and invisibles (areas in which Britain's supremacy was still unchallenged) further served to push the problem of declining competitiveness to the shadows.[15] The redirection of Britain's export trade and the emergence of multilateralism, then, allowed her to maintain a steady growth rate of exports which, though lower than the growth rate of GNP, was higher than that of the manufacturing sector (the discrepancy being accounted for by Britain's overseas investment and her heavy reliance on invisible earnings).[16]

In this context India's importance for Britain assumes special significance. Not only did the former provide large markets for Britain's staple exports, she also played a pivotal role in maintaining stability in Britain's payments position by virtue of the fact that she enjoyed the largest surpluses precisely with those countries with whom Britain had her largest deficits. Indeed, hindsight allows us to say that India's special significance for the British economy was a reflection of a serious malady that beset the latter—a malady which was to be especially debilitating as the early years of the twentieth century moved on. Industrial organization in Britain was slow in following the developments in the US, Germany and Japan towards 'industrial oligopoly, hierarchical managerial bureaucracy, vertical integration of production and distribution, managerial control over the labour process, the integration of financial and industrial capital and systematic research and development'.[17]

In contrast, Britain's major industries and their channels of distribution were characterized by numerous small-sized firms, each holding a small share of the market and functioning within a relatively simple framework of managerial organization and technology. Long-term finance continued to be provided by personal fortunes, retained earnings and country banks, and national financial institutions only stepped in to supply short-term working capital. The bargaining power of labour, meanwhile, increased over the years with work-place unions being supported by national unions in times of conflict, and this, along with the non-orientation of the educational institutions to the personnel requirements of industry, thwarted innovations in techniques of management. The growth rate of industrial productivity continued to register a decline, the efficiency lag being most pronounced in her key export sectors, namely cotton textiles, coal mining and iron and steel. Not only were these traditional industries technologically static, they were so firmly entrenched in Britain's industrial structure as to prevent their giving way to the industries of the future, in which the USA and Germany were already making their mark. In 1907, cotton textiles, coal mining, iron and steel, and general engineering accounted for 50 per cent of net industrial output, 25 per cent of working population and 70 per cent of Britain's export earnings. In the event, their low growth potential and static technological state were nothing short of a disaster for Britain, 'overcommitting' her economy to these industries.[18] This 'overcommitment' was further reinforced by the pattern of overseas lending, which served to tie these 'staple' industries to a narrow range of export markets. Moreover, the alignment of the financial institutions with overseas trade and lending created a disjunction within the economy and, arguably, contributed to the scarce supply of capital flows into the new industries, thus rendering a structural change in favour of high-productivity industries even more difficult.[19]

But until the outbreak of the Great War, multilateralism and prospering primary-producing countries allowed Britain to sidetrack the important question of the retardation of the domestic manufacturing sector, and the need for major organizational changes in British industry. The First World War and its aftermath brought these problems to the fore. Already, the USA was a rising competitor. The demand generated by her allies, and the move into export markets formerly dominated by the belligerents, gave a major fillip to industrial production in the USA. By 1920, she had achieved a 20 per cent rise in her level of industrial production. Japan was the other beneficiary, and moved strongly into the Eastern markets for cotton textiles. The War had also encouraged some import-substituting industrialization in Britain's imperial markets, and partly as a consequence of this, the share of her major exports in world trade declined. All these combined to make the need for structural transformation in Britain more acute. She was to face the post-War years with an archaic system of economic organization marked by institutional and intellectual rigidities sustained by powerful and influential vested interests. The cotton textile industry symbolized the problem—an industry most vulnerable to competition and technological change—which (along with coal) dominated British exports in 1913.[20] Overall, the system was deeply resistant to change and not in consonance with the requirements of times when there were rapid changes in world trade, and when the seemingly unshakable pre-War international order of trade and investments was disintegrating around Britain's shoulders.

Between 1919 and 1939 world trade as a whole was stagnant,[21] but there was a marked change in the commodity pattern. There were sharp increases in the shares of machinery and transport equipment, relatively slower increases in the case of metals and chemicals, stagnation in the case of 'other metal products' and 'other manufactures', and a sharp fall for textiles. [See Table A]

An examination of Britain's contribution to world trade shows that while her share in all commodities fell between 1913-1929 (from 13.9 to 10.8 per cent) she maintained her share in most groups of commodities fairly well between 1929 and 1937. Between 1913 and 1929 the most spectacular falls occurred in machinery, transport equipment and textiles, i.e. in Britain's most important staple industries *and* in the industries which showed the greatest global rates of growth.[22] [See Table B] Part of the reason for this dissapointing export performance

TABLE A
Commodity Pattern of World Trade in Manufacturing

Year	*a*	*a*	*a*	*b*	*b*
Commodity	*1899*	*1913*	*1929*	*1929*	*1937*
Metals	11.5	13.7	12.1	11.9	15.3
Machinery	8.0	10.4	13.9	14.5	16.0
Transport Equip.	3.8	5.4	9.9	9.8	10.5
Other metal goods	7.0	6.5	5.9	5.9	6.5
Chemicals	8.3	9.1	8.4	8.5	10.6
Textiles	40.6	34.1	28.7	28.7	21.5
Other Manufactures	20.8	20.7	21.1	21.0	19.5
ALL	100.0	100.0	100.0	100.0	100.0

a: excluding Netherlands
b: including Netherlands
SOURCE : A. Maizels, *Industrial Growth and World Trade* (1963), p. 163.

TABLE B
Share of U.K. Exports by Commodities

Year	*a*	*a*	*a*	*b*	*b*
Commodity	*1899*	*1913*	*1929*	*1929*	*1937*
Metals	36.1	25.8	22.8	16.8	14.1
Machinery	37.7	28.0	15.5	16.9	17.6
Transport Equip.	60.0	35.8	16.2	15.0	14.5
Chemicals	19.6	20.0	17.5	16.0	16.5
Textiles	41.9	42.8	33.1	33.2	37.0
Others (incl. other metals) 18.8	18.8	19.5	16.0	12.8	13.8
ALL	33.2	30.2	23.0	22.4	20.9

a: in 1913 prices and excluding Netherlands
b: in 1955 prices and including Netherlands
SOURCE : A Maizels, *Industrial Growth and World Trade*, p. 189 and Appendices A70 to A77, pp. 488-501. Cf D.H. Aldcroft and H.A. Richardson, *The British Economy*, Table 11B, p. 65.

was the growing cost of British Exports. [See Table C]. It was precisely in transport equipment, machinery and textiles that the U.K.'s competi-

TABLE C
Trends in U.K. Unit Export Prices Relative to her competitors*
1899 = 100

Commodity	*1913*	*1929*	*1937*
Metals	101	97	98
Metal goods	97	94	67
Machinery	98	119	123
Transport Equip	110	150	151
Chemicals	128	122	111
Textiles	112	131	155
Others	107	110	114
All Manuf.	113	127	140

SOURCE : A. Maizels, *Industrial Growth and World Trade*, p. 205 for "All Manufacturing"; Indices commodity-wise computed from Appendix tables B1 to B3, pp. 508-10.

* France, Germany, U.S.A., Japan, Others in Western Europe.

tive position deteriorated. The competitive disadvantage was due mainly to her high unit wage cost relative to other countries.[23] Some scholars have argued that in the 1920s Britain's export performance would have been boosted if sterling had not been pegged in 1925 at the pre-War rate of $4.86, which amounted to an overvaluation of perhaps 10 per cent.[24] But given the low price elasticity of demand for many British exports and the much lower unit wage costs of her competitors, a 10 per cent devaluation of sterling against the dollar (and of the currencies of Britain's sterling debtor countries who had merchandise surpluses with the USA) did not seem to have had any significantly favourable effect on British exports.[25]

The competitive weakness of British industry in overseas markets continued through the 1930s as well, but significantly there was little further shrinkage in her *share* of world markets, mainly because Britain's empire provided a cushion with its system of preferential tariffs. In fact, as noted above, Britain's trade with her empire had been growing even before the War, when she survived her loss of competitiveness by diverting her staple exports mainly to the primary producing imperial markets. The proportion of British exports going to the empire, which stood at 26 per cent in 1870, had risen to 34.2 per cent in 1910.[26] This pre-War trend was reinforced by the War and carried into the 1920s. By 1929 the share of the empire in British exports was 39.5 per cent.[27] The interlocking of Britain and her empire was further affected by the diversion of British capital exports, although the volume of these exports had decreased. The empire had taken as much as 47 per cent of British investments in 1913 and by 1930 the share had further risen to 59 per cent.[28] In the 1920s as multilateralism began to collapse, for the first time there appeared to be a more frequently visible direct connection between capital exports and the sale of British goods.[29]

The increasing value of the empire for British exports in the 1920s came about in the context of her competitive difficulties and rising tariff barriers in world markets. But this reliance on empire countries whose main exports were primary products was a precarious one. Since the end of the War their difficulties had been mounting. From 1926 the terms of trade moved markedly against primary products and began to affect the incomes of Britain's imperial customers. As it was, her exports had suffered a dramatic setback since 1914; now their performance deteriorated further, the level of imports kept rising, the visible trade deficit widened and the unemployment situation worsened.[30] Under these circumstances, the Dominions' demand (voiced since the early 1920s), that their exports have preferential access to the stable British market for such goods began to coincide with the growing appeal of arguments within Britain which emphasized the benefits that protection to domestic industry, along with a closer commercial integration with the empire, seemed to offer.

Although Britain was willing in certain areas to utilize the potentials of an empire-oriented economic strategy,[31] she refused to accept the idea of a closed empire and to repudiate free-trade in principle, even if she had departed from it in some ways.[32] She held on to the hope of re-creating the pre-War pattern of flow of goods, investments, and multilateral settlements. After all, she had the most to gain from a return to the system that had served her so well, and on her part did all she could to affect such a return. She took the lead in organizing international efforts to remove administrative controls, to free trade from embargos, quotas and fluctuating tariffs, and to re-establish the gold standard. Soon after the War Britain quickly sought to revert to a peace-time economy, loosening government controls. And although, as already mentioned, Britain in the 1920s was not a free-trade country in the old sense, in comparison with most European countries her tariffs were by and large moderate and stable. In her bid to restore effective

multilaterality of trade and payments she maintained virtual free-trade in her empire, except in the Dominions which could not be quarantined from contracting protectionism. In this and in other ways—most dramatically of course (and, at the chosen parity, most self-destructively) in the return to Gold in 1925—Britain reaffirmed her unshaken faith in the pre-War order.

In the immediate post-War years most European countries also sought to return to the apparently reliable international order of the pre-1914 days. But the politics and economics of these countries had undergone major changes, and these thwarted co-ordinated actions that could help revive the old order. The return to gold, for example, was through separate national decisions, without a simultaneous and realistic alignment of national price levels and exchange rates. Besides, despite the 'decontrols' and retreat from economic interventions after the War, the national governments had become susceptible to domestic political and economic pressures for fiscal freedom and an active economic policy stance, and this ruled out any full-fledged restoration of the pre-1914 'automaticity' of adjustment of the national economies to international pressures. But, most critically, the conditions which had allowed Britain to underpin the working of the international financial system did not survive the First World War. That ability had depended upon sterling's position as the premier international reserve currency and London's secure short-term creditor position, which in turn depended ultimately on Britain's own payments surplus and her ability to invest abroad. This had allowed Britain to administer the gold standard from a very narrow reserve base.[33]

The War substantially impaired London's short-term creditor position, while it also produced a very noticeable deterioration in Britain's trading position, and this became more pronounced after the mid twenties. Significantly, the most serious deterioration was with regard to the 'dollar area', threatening the British pattern of multilateral settlements. And although until 1929 Britain's invisible earnings were able to more than offset the widening deficit on trade account, the bases of her invisible earnings had been fundamentally weakened. During the War, she had to sell off nearly 10 per cent of her overseas assets, her debtors had defaulted, and she had herself borrowed heavily from the USA. Meanwhile, her shipping earnings declined as foreign merchant marines rose and freight rates fell. The continued health of her invisible earnings in the 1920s had come to depend substantially on overseas investment

incomes, a large proportion of which came from cyclically sensitive equities, and on War debts and reparation payments, thus making her payments position far from secure. For the 1920s as a whole, in fact, Britain's current account surplus was shrinking in both monetary and real terms. Moreover, despite attempts to recover London's role as a financial centre through the maintenance of high interest rates in order to attract foreign short-term funds, it was difficult to retain such funds because Paris and especially New York had emerged as strong rivals, and changes in interest rates at these new financial centres encouraged quick transfer of short-term funds from one to another. These developments together drastically reduced Britain's ability to invest abroad on a large scale, which could have helped to stabilize the international economy and restore London as the capital of international finance.

In fact the new leader of the post-War world was the USA, and the efforts to restore the international order were doomed to failure if the US refused to associate with them. The USA was now the major capitalist power in the world—the greatest manufacturer and exporter, the principal creditor and investor (with a strong reserve position, not dependent on speculative short-term flows), and an important buyer of primary goods. The international economy and the pre-War pattern of multilateral settlements now came to depend critically on the performance of her domestic economy, and especially on her commercial and financial policies. Indeed after the initial years of post-War turmoil, between 1925 and 1929, multilateralism[34] and the gold-standard system appeared sustainable largely because of substantial lending—mostly short-term and some long-term—and the volume of primary product imports by the USA. Yet the USA was not inclined to play the 'international order' game by the rules that Britain as the hegemonic power had so scrupulously followed before the War, and which the latter had come to regard as vital for its stability. The US might have wanted a world of free flow of goods and capital, but she was more committed to grant protection to domestic interests, agricultural or manufacturing, if they demanded it against imports. Moreover, a considerable proportion of US short-term investments went to Germany (a heavy borrower at this time) who used them for long-term projects and to pay her annual reparation payments. The latter in turn allowed European ex-allies to meet their War debts to the USA. There was, thus, a circularity in the flow of funds unconnected with the trade of real goods and services. But the recipients (especially France, for reasons of security) were not

prepared to scale down reparations, and the US was most unwilling to forget her War credits. In such a context, any cutback in US lending to Germany was certain to affect the latter's ability to meet her debt-servicing and reparation charges, and thereby lead to a 'scramble for liquidity' among Central European countries. This could lead to a strain on Britain, whose reserve position was low and who was a war debtor to the USA.

In addition, a part of US lending in the 1920s went to some primary-producing countries, allowing these countries in these troubled times to meet their deficits with the manufacturing countries of Europe, and so enabling the latter to pay for their imports from the USA.[35] But although she had the resources to place capital abroad, US foreign lending was, unlike pre-War Britain's, not in counterpoint to her domestic investments, but was positively responsive to the business cycle of domestic profits and interest rates. US monetary policies were oriented towards her own domestic requirements rather than towards the stability of the international economy through counter-cyclical foreign lending. After all, in contrast to Britain, US interest in the health of the international economy was, in the words of Roosevelt, 'secondary to the establishment of a sound national economy'.[36] In the case of Britain, the two were perceived as inextricably linked; in the US they were not, and once that disjunction had been effected it was only a short step for her to find the New Deal more seductive than the Old Order.

From mid 1928, net US lending began to decline sharply because the Federal Reserve Board raised interest rates to check a mounting speculative boom in the domestic economy. This provoked a rush among the debtor countries to draw on their gold and foreign exchange reserves to maintain their payments position, and also curtailed European demand for primary products. To make matters worse, from the middle of 1929 US domestic activity plummeted. While the financial crisis built up and foreign loans halted, US imports of primary products, already facing falling prices, severely declined. In a bid to maintain their foreign incomes to settle their accounts, primary producers sought to dump their goods onto an already glutted market, and the world slid into the deepest depression in its modern history.

Meanwhile, from the summer of 1928, US farmers, confronted with declining prices and difficulties in paying their mortgages, had begun to find political support for tariffs. Soon the demand for tariff protection came to be extended to manufactured goods as well, and resulted in the

Smoot-Hawley Tariff Act in June 1930, sharply reducing the ability of debtor countries to earn foreign exchange. Commercial retaliation by other countries was swift and widespread, barriers to imports rose at an accelerated pace, nullifying the efforts of various international conferences right up to 1930 to prevent higher tariffs—if not to bring them down. The collapse of international trade was hastened, leading to currency devaluation and even default by debtors. And in 1931, the entire international credit structure was in disarray.

The onset of the world depression had severe consequences for Britain. As prices fell internationally, her primary producing customers within and outside the empire suffered the most, and Britain began to lose these impoverished markets to cheaper producers of manufactures. Her staple exports were the worst affected and unemployment soared.[37] In a climate of precipitate decline of multilateralism, rising protectionism, developing economic blocs, increased competition in Britain's imperial markets and the dumping of foreign goods in her substantially open domestic market, businessmen and their Conservative supporters intensified their pressure for a comprehensive measure of tariff protection and for an active strategy to minimize the effects of export losses by maintaining British competitive ability in the empire markets through the system of Imperial Preference.[38] And although the second Labour government formed in July 1929, remained committed to free-trade and financial orthodoxy, by early 1930 its economic advisers (Keynes, Hubert Henderson, G.D.H. Cole, along with the astonishingly brilliant recent recruit to the party, Oswald Mosley), began to espouse tariffs, import controls, subsidies for exports and a cheap money policy to stimulate domestic investment. By September 1930 workers too joined the industrialists in prescribing an inward turn from the world economy and the formation of an empire economic bloc.[39] But the government vacillated; the question of intra-imperial preferences brought up by Canada at the Imperial Conference in October 1930 was deferred until the next one to be held in 1932.

The acute contraction in the volume of international trade, meanwhile, began to hit Britain's invisibles even harder than her visible exports, and the traditional balancing items of Britain's current account appeared to be hopelessly in trouble. The Macmillan Committee Report on 13 July 1931 revealed the extent of this hopelessness and also pointed to the precarious financial position of Britain from which she had to meet her foreign sterling liabilities. While experts on the committee

recommended import controls, expansionary policies, and even devaluation to deal with the domestic repercussions of the trade depression, the European financial crisis spread to London. Many believed that the flight from the pound was because of the revelations made by the Macmillan report. In fact, however, the run on the pound had been already sparked off when business recession in Europe put severe strain on the financial resources of Austria's major commercial bank. As commercial banks in smaller European countries scrambled for liquidity, German banks resorted to a moratorium on their foreign liabilities, and this led the former to sell sterling to augment their gold reserves. London banks which had much of their foreign depositors' short-term money locked up in Germany, found themselves in trouble. By end July the Bank of England had lost a quarter of its reserves in gold and foreign exchange in defence of the pound. Efforts to organise an international loan for Germany and a final settlement of the reparations to ease the pressure on London failed, mainly because of political tensions between France and Germany. At this stage the May Committee majority report on 31 July predicted a major budget deficit for 1931, and recommended cuts in public expenditure of £97 million, including a 20 per cent cut in unemployment benefits.[40] The recommendations found great sympathy from the Treasury under the ultra-orthodox Chancellor Philip Snowden, and from the City bankers who insisted that to save the pound on the gold they needed foreign loans, and for this a balanced budget was of the essence. The Labour government fell for it, and soon fell because of it. The trade unions, led by Ernest Bevin, who advocated devaluation, opposed cuts in the dole and withdrew their support to the government.

The first National Government pursued the objectives of the fallen Labour government but failed to save the pound. Renewed difficulties in Germany induced further withdrawals from London, this time chiefly from Amsterdam. The pressure on the pound increased when naval men of the Atlantic fleet at Invergordon struck work against pay cuts, creating fear of political instability in the heartland of economic liberalism. On 21 September Britain was driven off the gold standard.

For a few months Britain determinedly adhered to financial orthodoxy and free-trade. She still hoped to return to the gold standard (within six months) and to lead the world against trade restraints. But increasingly it became clear that she no longer possessed the financial and commercial strength to stabilize the international economy, and that

the one country that could, would not. Politicians were now under pressure to move away from a concern with the international economy and the conditions of order in it. Theory and policy alike became more involved with restoring the health of the domestic economy by dealing with the overriding questions of employment and output, budgetary and balance of payments positions and the fortunes of the pound in ways that departed from the established open-economy framework. The 'pure milk of free-trade gospel'[41] no longer promised sufficient nourishment, and its votaries soon lost out to those who prescribed protection with a system of empire preferences for the nation's ills. The second National Governments formed in November 1931, had Neville Chamberlain, son of Joseph, as the Chancellor of the Exchequer. True to his heredity he immediately had an Abnormal Importations Act passed to stem the tide of foreign dumping in the context of Britain's dismal export showing and rapidly falling invisible incomes. The year ended, despite an improvement in the terms of trade, with a deficit in the current account. Such a deficit had occurred twice before since the War, but this time there seemed little possibility of a revival in Britain's visible and invisible earnings in the foreseeable future. The time was clearly ripe for Neville Chamberlain to deal the final blow to free-trade.

In February 1932 he introduced the Import Duties bill, which was enacted without any trouble and came into effect on 1 March.[42] The Act instituted full-scale protection with a 10 per cent general tariff, excepting on empire goods, and the rate was doubled in April. Its basic aims were to safeguard the country's payments and the government's revenue positions, to help divert spending from imports to domestic products, thereby encouraging the 'new' industries,[43] and to induce the ailing staple industries to set their houses in order with statutory intervention by the government if necessary.[44] More importantly for our purposes here, it allowed Neville Chamberlain to fulfil, at least partially, the greatest of his filial missions—the inauguration of a comprehensive system of Imperial Preference (some sort of preparation for which had already begun following the Imperial Conference in 1930).[45] In the prevailing circumstances of international economic disintegration, emerging autarkic blocs, contracting levels of world trade and Britain's competitive weakness coupled with an unfavourable commodity structure, the urgent need to formulate a commercial strategy that would turn her away from the world and centre on the empire carried great conviction. British industrialists' prognostication that the

'competitive position of Great Britain, or of any other Empire country individually in the face of . . . economic groupings (as that of the USA in North America) would be an extremely disadvantageous one' rang true. Their claim that Britain had 'the possibility of creating together with the Dominions, India and the other colonies, an economic group of unlimited possibilities' sounded unexceptionable. Such an imperial grouping, declared the FBI, was a 'vital and immediate . . . necessity;' it looked upon the empire 'not from the sentimental or altruistic reasons but from the point of view of practical self in-terest'.[46]

So Britain and the Dominions, along with India, met around the table at Ottawa. (The case of India and the Ottawa Conference has been discussed separately). Many of these countries had already included some preferential rebates in favour of British goods in their tariff schedules since the War (in return for similar preferences for their goods in the British tariff), but these were of limited significance. At the conference Britain hoped to achieve a substantial clearing of the 'channels of trade amongst ourselves', as Stanley Baldwin put it,[47] through a lowering of tariffs within the empire. While British official delegates might have professed that this was a step intended not to insulate the empire from the rest of the world but to set an example to the latter and encourage it to return to conditions of freer trade, other advocates of empire trade and 'imperial economic cooperation'—British industrialists and financiers—regarded an imperial customs union as a more lasting strategy of survival. This was in view of the structural difficulties of domestic industry and the new conditions in the world economy which seemed to have come to stay.

Creating an imperial autarky was not, however, an easy business. While Imperial Preference was attractive to the Dominions because at this time Britain was the only major market for their exports, it was also true that their governments could not neglect the now substantial industrial interests in their countries, as well as their own revenue considerations, in their keenness to benefit their farmers. Britain, on her part, had to strike a delicate balance between protecting her domestic agricultural interests on the one hand, and granting empire countries preference over foreign suppliers of primary products on the other.[48] Besides, the Dominions relied heavily on customs duties to keep their revenue position secure, a matter in which British financial interests were closely involved, since these countries were debtors to London; Britain could not therefore press for greater preferences for her exports if this was going to adversely affect the Dominions' budgetary position. (In fact revenue imperatives ensured that preferences for Britain would be gained not through a lowering of tariffs on her goods but by increasing them on 'foreign' ones.) All this meant that economic co-operation and commercial integration would not come about in a rush of Imperial sentiment. The Ottawa Conference, not surprisingly, was marked by intricate and hardheaded bargaining between the Dominions and Britain.

In the negotiations for mutual exchange of preferences at Ottawa, the British appeared to have been outmanoeuvred as the Dominions secured advantages superior to those the mother country could gain for herself.[49] However, it seems an exaggeration to suggest, as many historians do, that Britain benefited little or even lost out at Ottawa if we take into account the constraints of the situation and the calculations and priorities of both her industrial and financial interests that were involved in the devising of the imperial preference system.

British industrialists had carefully reviewed the immediate and longer-term trade prospects of different British manufactures—both staple and 'new'—in terms of the conditions prevailing in the international economy; they also acknowledged the strength of economic nationalism in some of the empire countries and were fairly satisfied with the outcome of the Conference.[50] If the immediate terms of the exchange of preferences seemed less impressive from their point of view, it must be remembered that the potentially lucrative empire markets had been devastated by the Depression. Providing outlets for their goods meant reviving incomes in those countries, which in turn would bolster British exports with what preferences they had reviewed. After the massive decline in the volume of British exports in the three preceding years, it showed signs of reviving after Ottawa. The FBI's estimates noted this trend, and these were pointed out to the opponents of Protection and Imperial Preference who had predicted adverse effects on British exports as a result of commercial retaliation by foreign countries: 'On the contrary', the FBI emphasized, 'in a world of shrinking international trade and severe depression, British exports have ceased to fall, and even slightly increased'.[51]

Besides, British industrialists felt optimistic about the longer-term security of their commerce with the empire countries. Britain's insistent invocation of 'imperial economic co-operation' finally managed to get the Dominions to affirm the desirability of developing 'the resources and industries of the Empire . . . on sound and economic lines'; in-

dustrial co-operation alone could 'secure the best division of industrial activities among the several parts of the Commonwealth . . . [and thereby] the maximum efficiency and economy of production and distribution'.[52] For this purpose the Dominions had accepted in principle the British proposals for a 'scientific tariff' within the empire. Such a tariff required that the empire countries would afford protection to their manufactures against British products only in those industries which were 'reasonably' assured of success, and secondly, that the level of tariff protection (excepting for 'infant' industries) would be one which would give British producers full opportunity of 'reasonable competition' on the basis of relative cost of 'economical and efficient' production. British delegates had also acquired for British producers the right to represent their case before Dominion Tariff Boards in pursuance of these two principles.[53] British industrialists had pressed for their acceptance by the empire countries in the hope of encouraging the emergence of such complementarities of trade and production as would benefit Britain, and which yet could be shown to be least in conflict with the levels of industrialization already achieved by them. Their aim was, as they put it, 'not to arrest change but wisely to direct and facilitate its course'.[54]

Admittedly, the principles of 'scientific tariff' and 'economical and efficient production' defied accurate definition, and their application was susceptible to the strength and influence of local industrial and political pressures.[55] Indeed in some Dominions they were looked upon as British attempts to 'freeze' their industrialization.[56] Nevertheless, British industrialists had long believed that many of the problems in achieving economic cooperation could be tackled if representatives of industry, commerce and finance of the empire countries were 'fully consulted by their Governments on questions of policy', and, more importantly, if these representatives could 'get into the closest touch possible with a view to discuss as *a matter of business*, the most efficient and profitable organisation of Empire production . . . '.[57] They seemed to put great faith in the possibilities of 'goodwill' and 'cooperation' among businessmen, whereby matters of 'economics' could be isolated from those of 'politics', and British economic diplomacy came to be conducted within the framework established at Ottawa for many years to come with varying degrees of success in different Dominions.[58]

Overall, the Ottawa agreements do seem to have put some restraint on the rise of protectionism in the Dominions. After 1935 the latter

became noticeably less protectionist to the benefit of British exporters.[59] The index of the volume of British exports (1958 = 100), which had fallen from 74 in 1929 to 46 in 1931, rose from 1933 and by 1937 touched 59;[60] the empire's share in British exports rose from 39.7 per cent in 1929-30 to 46.6 in 1938.[61] [See Table D]. Apart from the gains made in the export of 'newer' goods—motor cars, electrical equipment, chemicals, etc. (whose share in total exports rose from 13.6 per cent in 1929 to 17.6 in 1937),[62] the Ottawa Agreements also benefited the 'old' iron and steel industry as well as helped to decelerate the decline in Lancashire's still important trade to some extent.[63] Furthermore, they provided a powerful bargaining weapon for negotiating reciprocal agreements with some 'foreign' countries, and retaliatory action against others, most notably against Japan in defence of Lancashire.[64] All these measures helped Britain to maintain her share of total world exports. Imperial Preference and the subsequent bilateral trading arrangements may not have set the world on the road to freer and greater trade, and their impact was to *divert* trade rather than *create* it, but in the perception of British industrialists, the gains made for their non-competitive exports were not negligible in these times of stagnating world trade, which was increasingly contained within separate blocs.[65] Even those industrial exporters for whom the benefits of the Ottawa Agreements were soon exhausted were eager to retain the Ottawa framework within which they could hope to renegotiate for better terms from the Empire countries.[66]

TABLE D
Share of U.K. Exports going to India, Australia, New Zealand and South Africa.

Year	*All Manufacturing*	*Machinery*	*Transport Equipment*	*Textiles*
1913	30.9	26.3	30.2	31.5
1929	29.9	33.8	30.0	28.0
1937	31.8	42.6	42.3	25.3

SOURCE : A. Maizels, *Industrial Growth and World Trade*, A70 to A76 pp. 488-96.

More significantly, the Imperial Preference system devised at Ottawa adequately served Britain's financial interests. It will be remembered that the empire countries were the major areas where British

capital was now concentrated (mainly in the public sector) and their governments were debtors to London. It was important from the point of view of British finance that these governments, heavily dependent on customs revenues, did not fail to balance their budgets since this was perceived as vital for maintaining exchange rate stability and for underwriting their debt obligations in London. Indeed, as mentioned earlier, this consideration prevented the British delegates from demanding preferential concessions, which they might otherwise have done. Moreover with the collapse of multilateralism, outlets for their goods had to be provided for them to acquire the necessary surplus on merchandise account if the earnings from British investments (and other 'invisibles') were to flow to London without default. (British industrialists took these aspects into account in their evaluation of the Ottawa agreements when they noted that 'settlement of financial transactions and payments for services enter into the picture').[67] In so far as the balances resulting from a favourable merchandise account of the empire countries were to be held in London it would insure the servicing of their sterling obligations without recourse to new loans, buttress the strength of the sterling and help in the development of the 'sterling bloc' (of which the empire countries formed the core).[68] Furthermore, the bloc, by linking the currencies of empire countries to sterling (and so insulating intra-imperial exchange rates from the effects of trade movements), provided an area of stability in which British exports could enjoy a continuing advantage over gold standard countries.[69] As the balances of the empire countries grew, the ban on overseas investment (imposed in early 1933) was lifted in their case later in that year; in July 1934 the 'sterling bloc' countries were encouraged to borrow to either add to their reserves held in London, or to buy British merchandise.[70]

In this context it is pertinent to note that when the pound revived from the early months of 1932 after the initial collapse, rising to $3.50 in early March and to $3.80 by end March, and the gold reserves of the Bank of England increased since the tempestuous days of 1931 to £150 million, the Bank believed that it had a chance to reclaim the international financial suzerainty of London. But British industrial and exporting circles wanted to hold the rate reached in early March. In this their views converged with those of the Treasury. The latter convinced the Bank and the City to trim its aspirations and concentrate on the more limited sphere of the sterling-bloc, improvements in its gold reserves notwithstanding: the exchange-rate was to be held around $3.40. To this end an Exchange Equalization Account was set up in April 1932. This allowed the Bank rate to be brought down to 3 per cent within a few days of the establishment of the Account, and to 2 per cent in June 1932, where it remained until the end of our period. The cost of servicing the national debt was reduced, 'cheap' money was made available to investors to provide goods to consumers who could ill-afford to buy tariff burdened imports, and British exports also received some help.[71] The lower rate of $3.40 did not negatively affect the terms of trade for Britain (which in fact kept improving) because the British import market had a monopsonistic position for many foreign exporters, and her attempts to buy less cheapened her imports.[72]

There were good reasons for the continued preoccupation with the export performance of British industry, 'old' and 'new', in the context of unprecedented levels of unemployment and its attendant political implications. Much has been written about the declining importance of the external sector for the British economy. It is true that during the inter-War years as a whole, the growth of British exports was not only less than the growth of world trade but also less than the overall growth rate of the economy.[73] Between 1911-13 and 1929 the ratio of foreign trade to national income had declined from 58.8 to 49.3 per cent, and between 1930 and 1938 there was a further fall to 33.9 per cent. The share of exports in national income declined from 23 per cent in 1920 to 17 in 1929 and to 10 in 1939.[74] But while this suggests that over these years exports were increasingly becoming less important to the British economy as a component of final demand, it cannot be read as indicating that exports were becoming irrelevant: they were still a strategic sector in the economy. After all even in the late 1930s exports accounted for 20 per cent of manufacturing output (as compared with 45 per cent in 1913 and 37 in 1929),[75] and export losses,—especially of the magnitude suffered during the Depression—could seriously affect the fortunes of manufacturing industry and of the domestic economy through their impact on industrial profits, and therefore on investment and employment. Indeed, as Alfred Maizels concludes, Britain's export difficulties in the inter-War years had a major retarding effect on the growth of the economy, which in turn reacted adversely on her relative competitive position.[76]

To be sure, in the 1920s, but especially in the 1930s, important changes were taking place in the British economy, tending to lessen its dependence on a narrow range of export-based staple industries. There

was a shift in the pattern of investment in favour of the so-called 'new' industries,[77] particularly in the 1930s (aided by a cheap money policy), and while the share of these industries in British exports was growing, exports as a 'source of growth' were relatively less important to them compared to domestic demand, which grew as a consequence of import controls and favourable terms of trade. But it would be folly to overlook the fact that this process of structural adaptation was particularly slow, and however impressed one might be at the growth of the 'new' industries, these were clearly unable to absorb the losses sustained as a result of the declining fortunes of the staples, whether in terms of employment , output, or contribution to exports.[78] Meanwhile, the adverse balance of payments had emerged as a constraint on growth generated simply by domestic demand, for export performance could, via the balance of payments constraint and its effects on home demand, throttle the growth even of industries not so overwhelmingly reliant on foreign markets. [See Table E]. Under these circumstances it was imperative not only to seek to arrest the decline in the export of staples, but especially to encourage the export of the products of the 'new' industries since these were precisely the areas in which world trade was growing.

TABLE E
U.K. Exports and U.K. GNP (in £ millions)

Year	*GNP*	*Exports*	*Exports as % of GNP*	*Balance of Trade (Imports minus exports and re-exports)*	*Balance of Payments*
1913	2392	525	21.9	-55	+237
1924	4044	801	19.8	-211	+ 72
1929	4444	729	16.4	-259	+103
1932	3902	365	9.4	-217	-51
1935	4449	426	9.6	-185	+32
1937	4961	521	10.5	-348	-56

SOURCE : *The British Economy: Key Statistics, 1900-1966*, Tables A, K and N.

Moreover, it needs to be emphasized that however much one may contrast the old 'staple' industries and 'new' ones in this respect, for the 'new' industries too, in the long term, growth prospects depended on their export potential. That they were less dependent on exports than

the 'staples' is undeniable, but to say this is very far from saying that the export market was unimportant for them. It would take us too far afield to argue this in detail, but one illustration may suffice. For motor vehicles for the years 1930-8 average annual exports amounted to as much as 16.7 per cent of average annual production.[79] Even more telling is the fact that by 1956 as much as 50 per cent of the output of motor cars was exported: this underlines the potentialities of the export market even in the inter-War period, and it is this potential which justifies fully the interest of motor car manufacturers in the export market.[80]

On the question of the importance of the external sector and the empire for the British economy, then, the analysis presented above makes it difficult to agree with Drummond's judgement that, given technical change, home investment and cheap food helping to raise standards of living in Britain, 'things would have been much the same if the Empire had never existed'.[81] Increase in the relative importance of home production did not compensate for the losses of production for export and of income from shipping, and from financial services associated with external trade.[82] And as argued above, because of Britain's competitive weakness in a changed international setting she could only turn to a commercial and financial approach that sought to exploit her imperial options. As a perceptive contemporary observer noted, 'The notion that Great Britain having parted with free-trade could orient her fiscal policy on anything but the empire is purely academic. A national protective economy which makes no use of the possibilities of empire is outside the pale both of politics and policy'.[83] In retrospect, the Ottawa agreements might well seem irrelevant as a *long-term* solution for Britain's economic difficulties. But at the time they were concluded they made a lot of sense to British industrialists and financiers: the second decade of the inter-War years was marked by a rising mood of economic nationalism and 'a comprehensive struggle for control of international finance and services as well as of commodity trade' with the aid of 'new techniques of radio communication, film propaganda and air transport'.[84] It is worth re-emphasizing that while Imperial Preference did not increase overall total trade, it did stabilize Britain's share of world manufactured exports as well as facilitate financial flows to London. In any event, hard-headed contemporary business opinion never doubted the usefulness of the flag and the political association of the empire; whatever obstacles Britain may have faced in the way of creating an ideal imperial autarky, in their view (arguably correctly) she

still derived considerable advantages from her empire connection. So British industrialists held on tenaciously to the system of imperial preference for the rest of the 1930s and in the 1940s, despite US attempts to make breaches in Britain's imperial autarky.[85]

British Commerce and India

India's commercial value to Britain in the inter-War years should be viewed in the light of these trends.[86] Throughout this period she continued to be one of Britain's most important markets. Up to 1935, India was the single largest market for British goods; after 1935 she was among the top three.[87] In 1913 British exports, to India were 16 per cent of her total exports and her share of the Indian market was correspondingly high (over 60 per cent). In the context of a stagnant world trade, some import substituting industrialization, and more significantly, the decline in total Indian exports as well as in agricultural prices and incomes from 1926 (with a drastic fall between 1928-9 and 1932-3), the Indian market was admittedly growing smaller.[88] After the boom in imports at the end of the War in 1919-20 (encouraged by the accumulated demand and an exceptionally high exchange-rate when the value of total imports rose to over Rs 347 crores compared to 191 crores in 1913), there was a fall until 1924-5, and then a slight revival; just before the Depression, in 1928, the total value of imports was a little over Rs 263 crores. Thereafter it fell dramatically, being halved in 1931 to Rs 130 crores, and showed signs of slow recovery after 1933-4 at a much lower level. It peaked in 1937 (Rs 173 crores), and stood at Rs 165 crores in 1939. The twenty-five year average for the years 1914-40 shows an annual decline of 2.33 per cent for imports.[89]

TABLE F
U.K. Exports to India

Year	*U.K. exports to India as % of all Indian imports*	*U.K. exports to India as % of all U.K. exports*
1926-27	47.8	12.7
1927-28	47.7	12.6
1928-29	44.7	11.7
1929-30	42.8	10.6
1930-31	37.2	8.1
1931-32	35.5	8.6
1932-33	36.8	10.0
1933-34	41.3	9.7
1934-35	40.6	10.2
1935-36	38.8	9.2
1936-37	38.4	8.2
1937-38	29.9	7.5
1938-39	30.5	7.4

SOURCE : H. Venkatasubbiah. *The Foreign Trade of India 1900-1940: A Statistical analysis* (1946); *Statistical Abstracts of the British Empire*; Mitchell and Deane, *Historical Abstract of British Statistics*. (1962)

Even though British exports maintained their share of the Indian market reasonably in the mid 1920s (though at a lower level compared to 1913), over the inter-War years as a whole British exports to India *were declining*, both as a percentage of total British exports as well as a percentage of total Indian imports owing to foreign competition. [See Table F][90] For two distinct kinds of reasons however, it would be misleading to surmise from the overall percentage statistics that the Indian market was becoming, or coming to be seen as, unattractive for British industry. The first reason is simply that whatever the decline, in absolute terms the Indian market was large and Britain had a very large share of it, however intrinsically weak the latter's competitive position might have been: Britain's share of the Indian market was considerably higher than her share in any other country, and her competitive disadvantage was much less evident there.[91] The second reason lies in the changing composition of Indian imports reflecting changes in India's internal economic life. The latter were far from substantial,[92] but while the percentage share of *manufactured* goods in India's imports remained remarkably stable, limited industrialization and changes in income distribution brought about important shifts in demand for foreign products within this broad category. Whereas in 1913, India was chiefly important for British staple industries—cotton textiles and iron and steel—over time the commodity pattern of Indian imports was being transformed in the direction of Britain's 'new' industries.[93] In terms of value, the Indian market grew smaller for cotton and other textiles and metals, namely iron and steel, copper, brass etc. These had averaged around Rs 73 crores between 1908 and 1913; in 1932-3 they had fallen

to 39.3 crores and were 34.2 crores in 1935-6. On the other hand, the value of imports of consumer goods like motor cars, cycles, electrical appliances of various kinds, wireless telegraph and telephone apparatus, cinematograph films and photographic apparatus, broadcasting equipment, refrigerating and airconditioning plants as well as of capital and intermediate goods (machinery, instruments, chemicals and dyestuffs, petrol and mineral oils, rubber products) increased from an average of Rs 17.2 crores between 1909-13 to 41.3 crores in 1932-3 and 50.2 in 1935-6.[94]

The absolute size (despite its contraction) of the Indian market and the changes in commodity composition of Indian imports of manufactured goods together, then, maintained India's commercial value for Britain. She was a major buyer, indeed often the largest buyer, of the products of Britain's traditional industries as well as of her 'new' ones, although here too British exporters were coming to face increasing foreign competition. Moreover, India's importance for British trade was coming to be viewed in terms not only of the existing value of the market but also its potentialities for the growth sectors of the British economy.[95] (In the long run, of course, the growth of demand for the goods of the latter was dependent on the investment in, and the growth rate of, the Indian economy.) Naturally, India figured prominently in the plans for Imperial Preference that were formulated in 1932.

In the heyday of multilateralism, India's key role in Britain's payments system had ensured the victory of free-trade over any schemes for an empire tariff bloc. The outbreak of the War, while it revived talk of a closed imperial economic system to serve Britain's strategic military and economic interests, also brought the Government of India under great financial and political pressure for a change in its tariff policy, and Delhi devoted a lot of time calculating how to lead India into an imperial tariff bloc if it become a reality, without arousing too much anti-British hostility.[96] With the end of the War, interest in imperial autarky subsided as Britain looked forward to a return of multilateralism. But in India increased revenue difficulties and the pressures of Indian politics (partly as a result of the 1919 Reform Act) led imperial policy-makers to affirm Delhi's autonomy in fiscal matters, and to qualify their faith in free trade with an acknowledgement of the virtues of 'discriminating' protectionism, though they deliberately left the door open for the introduction of preferences for British goods in India's tariffs. Once the disturbances of the immediate post-War years

settled down and international trade seemed to revive, India's visible trade surplus with the rest of the world allowed her to meet her visible and invisible deficit with Britain (a vital part of the latter being on public account). The Government of India's revenues stabilized and Delhi managed to operate its tariff policy without serious damage to British commerce, despite its commitment to the new policy of protectionism. In two cases, where tariff protection for Indian industry could threaten Britain's major staple exports, namely iron and steel and cotton piece-goods, the Government of India granted minimal protection and also succeeded in getting a measure of preference for these British goods. Delhi of course insisted that these preferences were consistent with the policy of 'discriminating protection', which meant minimum protection necessary for Indian industry with least cost to the consumer, and the lower duties imposed on British goods were called 'differential' duties In the political circumstances of the 1920s it seemed wiser to apply protectionism with such 'discrimination' than to try and get Indians to accept imperial preference as a general principle of India's commercial policy.[97]

The Great Depression brought this state of affairs to an end. Already from the mid 1920s there were clear signs that the multilateral system of trade and payments was unable to function as in the pre-War days owing to changes in internal production systems and political forces in individual countries. From 1926 the world agricultural depression set in, and it began to seriously affect the demand for Indian exports, and thereby India's trade surplus in commodities with which to square her invisible account with Britain. As the world crisis deepened, the prices of primary goods fell more than those of manufactures. The drastic slump in the value of India's exports cut down imports, hit government revenues, fuelled agrarian unrest and political agitation—which in turn weakened foreign confidence in the rupee and precipitated a serious financial crisis for the Government of India.[98] Meanwhile, until sterling was finally forced off the gold standard it seemed that in defending the interests of metropolitan finance London would pay little heed to Britain's commercial interests in India: India could simply not be allowed to default on her sterling obligations in London, and Delhi was forced to take stringently orthodox measures to restore the confidence of British investors by keeping its budget balanced, and by maintaining the rupee-sterling exchange. To achieve these ends, tariffs had to be raised, expenditures cut, and currency contracted. These measures on

the one hand hurt imports from Britain, exacerbating her problems of trade deficit, industrial stagnation and unemployment, and on the other further squeezed agrarian incomes in India, aggravating political worries in Delhi. In these critical circumstances Britain's espousal, after sterling was forced off gold, of an empire commercial and currency bloc (founded on the slogan of 'imperial economic cooperation') seemed especially appropriate for the protection of her interests in India. Believing as they did that even if economic misery was not an original cause of the anti-British political movement it certainly provided 'good conditions for the agitator to work in', the British needed to alleviate the adverse effects of the Depression on rural incomes, and thereby forestall the potentially formidable coming together of radical nationalism and rural disaffection.[99]

Monetary devices to raise Indian prices were considered utterly inadvisable by British financial opinion which ruled, much against the protests of Indian businessmen and the wisdom of officials in Delhi, that playing with currency matters would do nothing but harm. Devaluation of the rupee might raise domestic incomes and help government revenues, but would increase India's burden of financial payments in London, while at the same time hurting British exports.[100] On the other hand, a restructuring of tariffs based on a system of mutual preferences offered a means of achieving Britain's political aims as well as satisfying both British finance and commerce. Such a system, by providing an outlet for Indian exports at the existing exchange rate, would be a means to sustain Indian incomes, cool political tempers, revive the Indian market (and thereby government's revenues) to which British goods would have preferential access, but most importantly make enough sterling available for India to meet her debt charges in London without fail.[101]

The scheme for a preferential arrangement also seemed well timed for enlisting the support of Indian businessmen, for even those amongst them who were close to the Congress and resistant to British economic interests and policies had begun to look for a quick way to revive India's trade and incomes. They also wanted the establishment of political peace through a constitutional settlement between the British and Indian political leadership.[102] As discussed in chapter I, the possibility of a successful constitutional settlement had come to depend on sorting out the complicated business of balancing certain forms of concessions to Indians in the sphere of economic policy with adequate protection for

British interests. It was now clearly sensible for British interests to get Delhi to commit itself to the principle of Imperial Preference, with the consent and co-operation of Indian businessmen, for that would help ease the wrangling over the question of 'safeguards' for British commerce in the proposed constitution.

In the conditions of the times, the strategy of 'imperial economic co-operation' with its emphasis on the value of direct parleys between businessmen of the two countries on 'strictly economic lines', held the promise of arriving at an acceptable scheme of mutual preferences based on the principles of a 'scientific tariff' in the interests of 'economical and efficient production'. (It is interesting to note that the conditions found necessary by the Fiscal Commission in 1921-22 for the application of 'discriminating production'—namely, possession of natural advantages, abundant labour, cheap power and a large market—amounted precisely to one of the main requirements of a 'scientific tariff' now demanded by British exporters.) British proponents, private and official, of imperial 'goodwill' and 'economic co-operation' calculated that, in their bargains with Indian industrialists, the latter would not object much to preferences being granted at least to those 'newer' British manufacturers which were then not produced in India; such demands could be sold to them as being consistent with 'India's natural industrial development'.[103] In fact, over time, the growth of complementary industrialization, along with a rise in export earnings and domestic incomes promised by the Imperial Preference system, could increase India's demand for precisely these goods of the more dynamic British industries. But there was bound to be difficulty over the subject of preferences on British staple goods—steel and cotton—which enjoyed some protection in India, and their claims for further protection were under review by the Tariff Board. Problems were anticipated especially in the case of Lancashire cotton since this involved politically the most sensitive issue in Britain's commercial relations with India. The existing 'differential duties' in favour of Lancashire, acquired by imperial officials with some finesse, were now regarded by her as of little value in the face of falling Indian incomes and the astoundingly price-competitive Japanese intrusion into this vital if shrinking market.[104] And unless something was done to support her trade in these times of unprecedented adversity, Lancashire threatened obstinately to thwart, possibly successfully, the plans for constitutional reform. Officials in London and Delhi however were hopeful that the Tariff Board

reviewing the situation of the Indian cotton industry would recommend a higher tariff against Japanese goods specifically and increase the 'differential' in favour of Lancashire. Advantages thus secured would not be labelled 'preference', and could be actually presented to Indian opinion as marking no departure from the Government of India's policy of protecting Indian industry with 'discrimination'. So the negotiations for a scheme of Imperial Preference at Ottawa did not have to deal with the contentious question of cotton duties (as well as of the other staple, steel).

In the Ottawa Agreement signed in August 1932, Britain gave preferences on Indian goods worth about £ 47 million, and in return received preferences on British exports worth about £ 55 million (at 1928-9 prices).[105] In recommending the agreement for acceptance by the Indian Legislative Assembly, the Report of the Indian Delegation to Ottawa highlighted what India 'stood to lose' by standing apart from a general scheme of Imperial Preference. It could also appear irreproachable in declaring that 'the protection afforded to Indian industries has not in any way been impaired and India retains complete freedom to shape her tariff policy in the manner she thinks best'.[106] The agreement was ratified by the Indian Legislative Assembly in November 1932, provisionally for a period of three years. Meanwhile, British hopes of propping the prospects of Lancashire's trade in the form of a higher 'differential' tariff in her favour were dashed when the Tariff Board found that Indian industry needed to be protected against *all* imports. The Board's Report of 1932 was a black cap for British strategists trying to achieve a new equilibrium with Indians in defence of imperial power and profit. But all was not lost. Officials shelved the Report for the time being and concentrated on the Japanese threat. Since Japan had emerged as the common enemy of both Bombay and Manchester millowners, the versatile appeal of 'imperial economic cooperation' in these anxious times was exploited to attract them into negotiating a market-sharing scheme amongst themselves. In 1933 the cotton question was resolved, at least for the time being, by arranging the Lees-Mody Pact. This allowed Delhi to proceed with strong retaliatory action against Japan, and the terms of the Pact were incorporated in the Indian Tariff (Textile Protection) Amendment Act of 1934, which included considerable 'differential' margins in favour of Lancashire.[107] (The Tariff Board Report of 1934 on steel continued the 'differential' in favour of British steel and the future prospects of this

staple trade were further secured when a cartel scheme was worked out by British and Indian steel magnates.)

In January 1935 these private deals were brought under the official regime of Imperial Preference when they were tacked on as a Supplementary Agreement to the one signed at Ottawa. Now the affairs of these protected industries also came to be bound to the general clauses in the Ottawa Agreement relating to the principles of a 'scientific' tariff, whereby the level of tariffs on British exports of these goods was to be such as to 'give UK producers full opportunity of reasonable competition . . . ' in the Indian market. In return, the British promised to encourage the import from India of the raw materials used by their industries, especially raw cotton. Finally, in a bid to underline the virtues of separating 'economics' and 'politics' through co-operation amongst British and Indian businessmen, London and Delhi proclaimed that they would be especially receptive to any suggestions on tariff matters which might emerge from agreements reached by the accredited representatives of industry of the two countries.

This new appendage to the Ottawa Agreement, too, was sought to be defended by officials in Delhi as consistent with the policy of 'discriminating protection', and with their public claim that India 'retains complete freedom' in tariff matters. After all, as the delegates to the Ottawa Conference had pointed out, 'One of the most interesting things about the Indian system of protection is that it has led directly to what has been in effect . . . a preference for Empire goods' (i.e. 'differential duties').[108] The Supplementary Agreement in the official view, then, had done 'nothing more than crystallize their past fiscal practice and the principles [of 'discriminating protection'] which had been accepted . . . by the Legislature'.[109] But this time, Indian legislators reacted differently from the way they had in 1932; they refused to ratify the Supplementary Agreement. The Ottawa Agreement itself had never really acquired much support in India. This was largely because of the lack of wisdom of the Government of India in not involving, as advisers [illegible] its delegation to Ottawa, Indian businessmen with any political wit [illegible] influence who were also in fact in favour of negotiations and [illegible]ation with their British counterparts—a viceregal misjudgement [illegible] Lord Willingdon's excessive distrust of all businessmen who [illegible]ed to have any links with the Congress. He had narrowed the [illegible] down to those whose association with the Agreement was more [illegible] to damn rather than guarantee its political fortunes. Soon after,

the Depression began to lift and the Reforms Act of 1935 was passed, opposition surfaced in India, especially pointedly against the Bombay-Lancashire pact. In 1936 politicians in the Legislative Assembly, prodded by their friends in Indian industry (sullen at official neglect of them and particularly sore over London's dictatorial posture in the field of financial policy) rejected the Ottawa Agreement, supplement and all. It was, however, kept in force until a new preferential Agreement based on the Ottawa principle of 'goodwill' and 'co-operation' was negotiated.[110]

Tables F, G and H show that after the accelerated decline in Britain's share in Indian imports between 1929 and 1932, the Ottawa preferences managed to improve that share and make it relatively stable in different classes of goods until 1937. On the other hand, the Agreement increased Britain's share in Indian exports, which went up from 21 per cent in 1931 to 27.3 in 1932-3 and 35.5 in 1939-40. From the onset of the Depression, while the Indian market had collapsed, Britain's share in Indian exports was rising. Britain was the most stable market in these times, with a relatively inelastic demand for many imported foodstuffs and raw materials, and India had a semi-monopolistic position in some of these.[111] And even before the Ottawa Agreement, in 1931 (for the first time since the nineteenth century) India ran a merchandise trade surplus with Britain. Ottawa served to underwrite this and the surplus continued for the rest of our period,[112] a fact that has been much dramatized by some commentators: Indian exporters seemed to have gained more from the Agreement than their British counterparts.[113]

TABLE G

U.K. Share of the Indian Market

Year	Machinery	(i) Motor Vehicles	Tyres and Tubes	(ii) Chemicals	Textiles	ALL
1926	74.5	14.8	41.2	57.5	74.6	47.8
1929	71.6	12.7	32.5	54.4	71.3	42.8
1932	69.8	50.7	40.7	47.5	52.1	36.8
1935	64.2	35.0	76.5	50.4	59.6	38.8
1938	57.3	30.3	69.3	50.4	50.5	30.5

NOTES : (i) In numbers.
(ii) Chemicals includes dyes.

SOURCE : Same as in Table F.

TABLE H

Absolute amounts (in value or weight or number terms) of U.K. exports into India in comparison with total Indian imports in each category*

ITEM	*1926-27*	*1929-30*	*1932-33*	*1935-36*	*1938-39*[a]
METALS	406	486	140	214	133
(i) Iron and Steel	[879]	[971]	[325]	[448]	[267]
(in Th. tons)	199	172	238	224	155
(ii) Others	[838]	[676]	[829]	[904]	[461]
(in Th. cwts.) (aluminium, brass, bronze etc.)					
MACHINERY	8738	10053	6273	7272	8674
Electrical and non-electrical (in £'000)	[11728]	[14031]	[8985]	[11329]	[15129]
VEHICLES AND	2287	4156	4475	7726	5724
TRANSPORT	[19540]	[32705]	[8877]	[22060]	[18866]
EQUIPMENT	2154	3277	1253	2316	1767
(i) Motor cars, Vans etc. (in Nos.)	[3266]	[5472]	[2336]	[3078]	[2556]
(ii) Rubber tyres, tubes etc. (in £'000)					
CHEMICALS	2494	2660	1957	2363	2324
(including drugs, medicines, paints and colours)	[4340]	[4887]	[4119]	[4688]	[4615]
COTTON	20106	20112	13357	9767	4681
MANUFACTURES	[49425]	[43882]	[45103]	[44570]	[36459]
(i) Yarn (in Th. lbs.)	1457	1235	586	440	206
(ii) Piece-goods (in Mill. yards)	[1767]	[1883]	[1194]	[947]	[647]

NOTES : *Total Indian imports in each category given in square brackets [].

a. From 1 April 1937 the figures include trade with Burma (formerly classed as coastwise) and exclude direct overseas trade of Burma. Particulars for 1938-39, therefore are not strictly comparable with those for earlier years.

SOURCE : *Statistical Abstracts of the British Empire.*

But these apparent contretemps should not provoke a misreading of the importance of the Agreement for Britain, especially in view of the direct official stake in the financial aspect of imperial economic interests in India and its importance for the invisible account of Britain's balance of payments. The world slump had brought about a serious overall decrease in India's exports, and although partially counterbalanced by a falling off of imports, her surplus on merchandise account had shrunk considerably between 1929-30 and 1932-3.[114] With this the Government of India's ability to acquire sufficient sterling to meet its obligation in London was seriously threatened. These obligations (annual interest payment to British investors in government securities and other 'home' charges) had amounted to £ 17 million, and in the late 1920s and early 1930s ranged between £ 30 and £ 35 million (exclusive of repayment of maturing loans). The problem was made worse by political uncertainties which had sparked off a major flight of British capital from India. In fact from early 1930 Delhi found it impossible to buy remittance.[115] All this meant that Britain would not only have to restore foreign confidence in the rupee through strict control over India's financial and monetary policies, but also that in her attempts to establish bilateralism in trade relations with India under the system of Imperial Preference, she would have to ensure that India earned visible trade surpluses so that financial flows to London were guaranteed. Until Ottawa, between early 1930 and September 1931 India had been able to tide over the problem by drawing on her gold and sterling currency reserves and by borrowing, after which the situation was saved through a massive export of gold to the tune of £ 47 million by the end of 1932. But the Indian gold mine was not bottomless, and while India remained a net exporter of this precious metal for the rest of the decade (exporting £ 230 millions worth of gold by 1939)[116] an assured export surplus in other commodities was the lasting solution. Besides, apart from the current remittance requirements, India needed to build up reserves of £ 100 million as a condition for setting up the proposed Reserve Bank, and another £ 133 million to meet sterling (£ 66 million) and rupee debt maturing in 1938-9.[117] These vital considerations in favour of British finance also meant that while demanding preferences for British goods at Ottawa, sufficient attention was paid to ensuring the Government of India's solvency in revenues collected in rupees (and heavily dependent on customs duties) in order to buy the requisite sterling to meet its debt servicing and repayment obligations.

Moreover, the Ottawa preferences to Indian exports helped to maintain rural incomes and contributed to reducing discontent and political uncertainty. (Even after the Depression had lifted, guaranteeing the economic stability of India's rural populace was considered requisite in order to weaken nationalist opposition to the Raj. Viceroy Linlithgow, that ardent champion of the 'ryot', was willing to bet that he could 'lick' the 'bad boys with with old Gandhi well to the fore' if agricultural prices held.)[118] Finally, the apparently deft actions in defence of Lancashire's trade which the Ottawa framework provided expedited the passage of the Constitutional Reform Act of 1935.

Although Britain's financial imperatives and political priorities had somewhat reduced her bargaining power for her commerce at the Ottawa Conference, British industrialists were gratified with the fact that India had been drawn into the empire trade bloc, and were content with the preferential access to the Indian market acquired in these times of rapid changes and uncertainties. As noted above, between 1928-29 and 1931-2, when the Indian import market (in value terms) was halved, imports from Britain were reduced by 60 per cent: their value fell from Rs 133.2 crores to 44.8 over that period, and their relative share had dropped from 44.7 to 35.5 per cent.[119] Over the same period the relative share of her main competitors—Germany, USA and Japan—had improved from 6.3 to 8.1, 7.1 to 10.2 and 7 to 10.6 per cent respectively. After Ottawa, while Indian exports began to rise again and her import market showed signs of revival until 1936-7 (after which it was again affected by the two year recession in world trade starting in the USA), the value of Britain's total exports to India rose to Rs 44.8 crores in 1932-4 and to 52.6 crores in 1935-6 (having touched 53.7 in 1934-5).[120] After 1932, her relative share of the market moved upwards and stood at 41.3 per cent in 1933-4 and remained reasonably stable for the next two years, after which it began to recede again. Import of preferred goods from Britain (mainly the 'newer' goods) increased by 30 per cent in value (13.3 crores to 17.3 crores) between 1932-3 and 1935-6, and her share of the market for these goods rose from 40 per cent in 1932-3 to 46 per cent in 1933-4, thereafter falling to 44 per cent in 1935-6.[121] The rate of decline in textiles slowed down somewhat, and her share in non-preferred goods remained stable over this period. Meanwhile the value of imports from her main competitors in the category of preferred goods increased only by 8 per cent between 1932-3 and 1935-6.[122]

From 1935-6 onwards, however, competition, especially from low-

priced Japanese and subsidized German exports (but also from the USA and Canada) began to grow stronger over a widening range of commodities, and to threaten some of Britain's advantages gained through the Ottawa preferences. This competition affected Britain's share of the Indian market for both the older types of goods of common consumption, as well as for capital and intermediate industrial goods and the 'newer' consumer durables. But this only served to underline the importance of preferences for British exporters: 'Although . . . the preferential margin has not been sufficient to bridge the gap between United Kingdom and competing prices, there can be no doubt that the 10 per cent fiscal advantage has been valuable in assisting the United Kingdom at least to maintain, and in some cases to improve, her relative position in a number of highly competitive trades. It seems probable that without this advantage United Kindom exports would have materially lost ground under valuable heads . . . '.[123] Official trade experts calculated that in the former class of goods (whose import demand was stagnant or falling owing not only to domestic production but also the very slow recovery of incomes for the mass of the population, the upward movement of world agricultural prices since 1933 not having 'filtered down to the cultivator'), British exporters had at best limited prospects; preferences were certainly valuable in order to stay the long continued setback to their trade but any growth here would require preferences to be combined with a 'distinct improvement in India's exports', for 'then and only then will the cultivator regain the purchasing capacity that will enable him to become a purchaser on a considerable scale of imported, and particularly of the higher quality united Kingdom goods'.[124]

But the favourable results of preferences were unmistakably clear in the case of the relatively buoyant import market in the latter class of goods. 'It is most encouraging to note', concluded Sir Thomas Ainscough, Senior British Trade Commissioner, 'that in the newer highly technical industries United Kingdom manufacturers are successfully meeting foreign competition . . . '.[125] The growth of exports of these goods to India did not compensate for the decline in traditional exports, and they clearly had better trade prospects in the high-income economies of the Dominions than in India with its low level of domestic investment. Nevertheless, the Indian market was big, and the existing trends in industrialization and the patterns of income and demand distribution made British trade experts view it as one 'capable of vast expansion' for these newer goods.[126]

On the whole, then, whether with regard to traditional exports or these new goods with potentially expanding markets, British exporters recognized their weak international competitive position and acknowledged the value of 'imperial economic co-operation' and preferences in order to maintain, and in some areas possibly improve, their position in the Indian market.

So when the Ottawa Agreement was thrown out by the Indian Legislature in 1936, there was no lack of eagerness on Britain's part in seeking to renegotiate a similar Agreement and keep India within the established framework for the general regulation of empire trade. In fact, even before the denunciation, trends in Indian opinion, political and academic,[127] had prompted British officials and industrialists to prepare for a fresh round of intricate negotiations, this time with the involvement of the politically more influential and astute Indian businessmen; they had drawn important lessons from the fate of the Ottawa Agreement. They realized that now that the economic pressures and political dangers of the Depression years had eased off, Indian big business was returning to an openly oppositional posture against government policies, and was seeking to consolidate its links with the Congress in the emerging political environment after the passage of the Reforms Act. (This tendency became more marked after the Congress accepted office in the provinces and the need became more manifest for a working accommodation between business interests and the political aims of the Congress.) This meant that they would prove tough bargainers in any new negotiations, more so since Britain's position would be constrained for much the same reasons as in 1932: the need to worry about India's export surpluses and Delhi's revenue position in order to meet the urgent demands of British finance as well as to back the hopeless cause of Lancashire in the Indian market.

But British businessmen and officials still hoped to arrive at a profitable compromise with Indian businessmen who, despite important changes in their political calculations *vis-à-vis* the Congress, were not averse to an agreement on 'purely economic lines'. The latter's dependence on advanced economies could be exploited: 'We must rely more and more in future', advised Sir Thomas Ainscough, 'on the supply of capital products and technical equipment, thus aiding [India's] own development with our experience and technique'.[128] And in the generally restrictive trade conditions in the world officials decided to give great publicity to the fact that Britain was buying more from India than selling

to her since the Ottawa Agreement. It was 'wiser' they calculated, to emphasize this fact rather than 'to say too much about getting a bigger market in India for British manufactures'; it was more important to get the principle of 'imperial economic co-operation' in place first, and to 'impress [upon] the Indian agriculturists what a help the British market is to them', so that 'when they realize that they cannot hope to expand their possibilities if Indian industrialists are too selfish and hostile, then Indian agricultural opinion will fight' the battle of the British exporters for them. That would be the time when the British government could make 'firm demands' with hopes of success;[129] more specifically, if Indian raw-cotton growers could be played off against Indian industrialists, the latter might be prompted to concede Lancashire's demands.

The negotiations for a new trade agreement dragged on for three years. The details of the strategies and constraints of the two sides and the final outcome have been discussed in chapter 9 below. What is important to note here is, first, that it was the requirements of imperial finance and Lancashire which weakened British bargaining power. Nevertheless, London and Delhi were able to secure preferences for the manufactures of the most competitive lines of (new) goods. The manufacturers of these goods it needs to be emphasized did not at any stage consider the Indian market a wasting asset or undervalue the importance of keeping India within the orbit of imperial preference. When from 1937 onwards their goods were unable to hold their share of the Indian market *despite* the existing Ottawa preferences, this was clearly a measure of the extent of their non-competitiveness, leading them to intensify their efforts to improve their sales, technical and service organizations in India.[130] Second, when the strategy of 'goodwill' and direct negotiations between industrialists of the two countries failed over the issue of Lancashire cottons, the imperial government did not hesitate to enforce the new trade agreement without the consent of Indians. In 1939, when clouds of another world war were gathering, the Raj was in no mood to conciliate Indian opinion beyond a point.

The Financial Stake

From the second decade of the nineteenth century, Britain was unable to live by her export of merchandise alone. The deficit in her 'visible' current account was made good by the earnings of the financial and services sector on 'invisible' account—income from overseas investment, banking, insurance, shipping. The importance of these earnings

for Britain's external account only increased with time. From the middle of the nineteenth century Britain began to invest capital abroad on a massive scale (although with wide fluctuations). The returns on these became the most buoyant element in Britain's invisible account, and of continuous importance to her balance of payments. From the late nineteenth century up to 1914, net incomes from these and other services not only paid for Britain's merchandise exports but also provided the surpluses for new overseas investments. These investments contributed significantly to the development of an international economy in which Britain held the pivotal place, and on which she came to depend heavily for her sense of well being. Her predominance among the major trading nations and her role as the financier and carrier of the world's commerce made sterling a key currency, as well as an international reserve currency. London became the world's banker and came to underpin the international financial system, the gold standard. The strength of sterling allowed London to function with a small holding of reserves and to invest abroad the rest of Britain's net surplus on current account. In 1914, Britain held foreign assets worth £ 400 million.[131]

The First World War, as noted above, brought this state of affairs to an end; loss of overseas assets, (whether through sales or default), Britain' war debts, and the rise of foreign merchant shipping, all worked to reduce her invisible earnings, while her loss of competitiveness was exacerbated and her merchandise deficit widened. All this adversely affected her ability to lend abroad and play a stabilizing role in the international economy.

Britain had gone off the gold standard at the end of March 1919. Wartime inflation had raised the British price level more rapidly than in the USA, and the financial authorities believed that it was essential to bring it down in order to return to the gold standard at the pe-War parity. Meanwhile, the post-War boom of 1919-20 created further inflation; its artificial nature marked by financial speculation, hiked up the fixed charges of British industry (especially cotton textiles, where speculation was most marked).[132] After the boom broke and the trade recession set in, they experienced grave difficulties on the export front. From April 1920 British financial policy makers began to act on their belief that deflationary measures were called for: a return to the gold standard would not only help London to regain its central place in the international economy and rejuvenate the structure of Britain's trade settlements, it would also cut wage costs and render Britain's exports

more competitive.[133] But the return to gold in 1925 at the pre-War parity, combined with serious diplomacy by British authorities in support of the use of sterling as a reserve currency, did not achieve the desired ends, and these failures began to make Britain increasingly dependent on her empire for the health of her finance and commerce.[134] The over valuation of the pound added to the difficulties of British exports; their dismal performance combined with the rising level of imports led to marked deterioration in her visible trade account, and Britain had to rely more on her invisibles to balance her payments. Her old assets had shrunk and her service earnings fell, but soon after the end of the War Britain had resumed her foreign lending (though on a lesser scale than before the War) and her invisible earnings more than offset her deficit on trade account until 1929.[135] However, as noted earlier, these British foreign investments of the 1920s exceeded the current account surplus (including invisibles) and drew upon flows of speculative funds into London; not surprisingly, when these funds moved out it precipitated a crisis in London. The Depression, meanwhile, hit Britain's exports very hard, and her invisibles harder; her current account went into deficit.[136] In the 1930s, the volume and returns on foreign investments tended to shrink when annual repayments exceeded new investment, and these made it all the more necessary for Britain to maintain the existing sources of invisible income.[137]

Over the inter-War years the geographical distribution of British investment, as already noted, had become concentrated in the empire countries, and by 1930 the empire's share of these investments had risen to almost 59 per cent. India (including Ceylon) had become the second largest area of investment within the empire.[138] Some idea of India's continuing contribution to Britain's net balance of invisibles (including incomes from investment) during the 1920s and 1930s can be formed from Table J.

By far the best estimates of British investments in India between the Wars (in the public and private sectors) are thosemade by A.K. Banerji. During this period, as in the period before the War, these investments were largely concentrated in the public sector—in government securities and loans, guaranteed railway stock, etc. These increased from £ 312 million in 1921 to £ 378.6 million in 1938. The Government of India's sterling debt, which rose from £ 169.8 to £ 262.5 million over the period (most of the rise took place in the early 1920s and the early 1930s) was by far the single largest element in British investment in India.[139]

TABLE J

Indian Invisible Remittances to the U.K. over the period 1922-36 (in £ millions)

Year	*India's net deficit invisibles*[1]			*Estimate of flow of invisibles to U.K. from India*[4]	*Flow of invisibles into U.K. from all sources*[5]	*Percentage of U.K. invisibles from India*
	Govt.[2] *Account*	*Pvt.*[3] *Account*	*TOTAL*			
1922	18.4	42.1	60.5	53.0	325	16.31
1926	19.4	47.6	67.0	57.4	449	12.78
1931	21.5	29.4	50.9	44.9	304	14.77
1936	19.1	41.4	60.5	51.5	327	15.75

NOTES : 1. Figures are from A.K. Banerji, *India's Balance of Payments* (1963), Table XXVI p. 90. Rupee values converted to sterling at rates given on pages 87-88.

2. Government Account included interest on public debt and pensions.

3. Private Account includes other items, i.e. freight, royalties, insurance and bank remittances, tourism and interest and dividends on private foreign investment.

4. It has been assumed that the return on private investment is divided between the U.K. and other countries in the same ratio as the paid-up capital as given in Banerji, pp. 148-200. For freight, insurance, etc. a conservative estimate of 85% has been attributable to the U.K.

5. U.K. inflow of invisibles on current account are from B.R. Mitchell: *Abstract of British Historical Statistics*, Overseas Table 16, pp. 334-335.

The servicing of these loans remained, throughout our period, a major preoccupation of government, both in Delhi and in London, and one which was seen as vitally important. In this perception, moreover, government's views converged with the views of the City. The loans issued in the name of the Secretary of State for India, and secured on the revenues of India. Over the inter-War years. the cost of servicing these (along with other 'home charges', salaries and pensions of British officials, appointed by the Secretary of State, and certain other expenditures incurred in London) amounted to around £30 million per year, which the Government of India had to remit from its limited revenue resources collected in rupees (with nearly 40 per cent of the revenues

unquestionably marked out for India's defence).It also needed to remain solvent and creditworthy in order to repay maturing debts.[140] All this meant, as mentioned earlier, that London had a direct interest in India's surplus earnings from exports and in the financial stability and credit of India: for the latter an orthodox balanced budget, 'prudent' monetary policy and maintenance of a stable currency were considered essential.

It was in this context that in the 1920s the question of the rupee exchange-rate assumed importance. The years between 1917 and 1924 were marked by violent fluctuations in the exchange rate, with attendant uncertainties for the government and businessmen alike, and it was generally desirable to quickly stabilize the exchange value of the rupee.[141] But unlike Indian businessmen, financial and political authorities in London and Delhi preferred a higher rate than the one which had prevailed before the War, one which would minimize the rupee costs of the Government of India's commitments abroad, thereby ease its growing revenue problems, and also improve its image as a trustworthy borrower in London. Besides, such a rate would be a boon to British exporters to India; it would also protect the pecuniary interests of British civil and military servants in India who could send good money home as well as look forward to a comfortable old age in England.[142] Finally, a high exchange and a contraction of currency would bring down prices, the inflation of which were seen by officials as being at the root of political disturbances in India. In 1919, when the rupee exchange rate was on the rise, the government had tried to hold it at 2s, but found it impossible because it had led to a steep rise in imports in relation to exports.[143] (In fact, imports ordered during 1920-1s howedup in the figures for 1921-2 in which India's commodity account showed a small deficit).[144] Then it fell below ls.3d in 1921. From early 1923 it rose again and touched 1s.6d in 1924 as world demand for Indian exports grew. Government decided to hold the rupeee at this rate through financial deflation (which it had begun from 1922 after a series of budget deficits), through severe cutbacks in its current and capital expenditure, and monetary contraction.[145] In 1926, the Royal Commission on Indian Currency and Finance (the Hilton-Young Commission) recommended ls.6d as the suitable rate, and thus armed the government to give it statutory embodiment. Indian businessmen, though not opposed to attempts at balancing the budget, had argued for maintaining the rupee at ls.4d since 1919, and resisted the contractionary measures designed to maintain ls.6d, a rate which, they argued, overvalued the

rupee by about 11 per cent: internal deflation was squeezing the credit market, adversely affecting internal prices and purchasing power, and raising wage costs (which had risen substantially in nominal terms since the outbreak of the war and were 'sticky'downwards), while the high exchange was providing an artificial encouragement to competitive imports into India. Together these were making the prospects of profitable investment in most industries very bleak.[146]

Officials had hoped to silence Indian criticism by appointing Sir Purshottamdas Thakurdas (that astute financier from Bombay, influential among businessmen, a critic of the government, worthy of a knighthood)[147] as a member of the Royal Commission. They hoped he would fall in line with the thinking of the majority and no effort seems to have been spared to make him do so.[148] Thakurdas nevertheless reiterated the arguments of Indian industrialists and, in a minute of dissent recommended the rate of ls.4d as the correct one.[149] But the Government, already predisposed to ls.6d, proceeded to peg the rupee at that rate in 1927. 'I think there can be little doubt', explained Viceroy Irwin, 'that the economic effects of imposing ls.4d would be very grave. . . . The effect on Central and Provincial budgets would be aggravated by necessity of an all round . . . extra taxation . . . '. But perhaps the most serious result of acquiescing to the demand for 1s. 4d. rate, Irwin feared, would be the greatly shaken international confidence, since it would afford evidence 'of the insecure foundations on which public finance depends'.[150] London and Delhi were prepared to 'certify' the ls.6d rate if the ratio bill faced defeat in the Legislative Assembly.[151] Many of the arguments of Indian industrialists regarding the consequences of deflation and high exchange rates were good, if at times a bit confused; India lacked a Keynes and the 1s.6d rate stayed. (Even Keynes' persuasiveness and great polemical energy had proved futile in resisting the return to gold at $4.86 in Britain—to the detriment of British industry, both industrialists and workers. The protest of Indian subjects was unlikely to change orthodox financial prescriptions thought suitable for Britain itself, and the influence of the treasury and the 'city fathers' rode triumphant in both countries, to the misfortune of both economies). Meanwhile, the world agricultural depression had begun and the terms of trade moved against the Indian peasantry. But more and more, ls.6d became sacrosanct in London's eyes as the one way to rule out any threat of default by India, to keep the budget balanced without recourse to increased taxation in politically senstive times, to

protect British exporters, and to prevent the 'whole creditor class, e.g. landlords, moneylenders, etc. [of India] . . . from extremes of hardship and injustice'; the burden of the peasant's indebtedness, in this view, was compensated by the cheapened imports he used.[152]

In the 1920s, officials still sought to assuage Indian suspicions of British manipulation of the exchange rate, and the way monetary policy was managed. So the proposals for the introduction of a gold standard with a gold currency (instead of the gold exchange standard)[153] of a Central Bank independent of the day-to-day functioning of the government were revived. A full gold standard with gold coinage was a long-standing Indian demand, and various official inquiry commissions since the nineteenth century had also supported the idea as one which would allow an automatic, self-regulating currency system to operate. The Babingon-Smith committee of 1919 had found it feasible, once the USA had lifted its wartime embargo on gold exports. But the City and the Bank of England strongly opposed it. India would absorb all the gold that the empire produced; these were better conserved in London to help England meet her obligations to the USA; it was far more useful to link the rupee to sterling, for then, wrote a leading London banker, 'we shall have all the benefits of India's large exports to help raise the general level of sterling. . . . The most effective way to raise sterling to a gold level . . . is first of all to get the whole empire on a sterling basis'.[154] The exchange disturbances of the next few years, in any case, forced the Government of India to give up the scheme. It came up again in 1926, but the Treasury objected to it on the grounds that Britain needed to keep all the gold she could get to support the sterling; the Hilton-Young Commission rejected the idea as damaging to the already unstable international financial system.[155]

The Commission, however, supported the idea of a Central Bank (Reserve Bank) which would take over currency and exchange management directed towards the maintenance of 'sound conditions in the Indian money market', of which a stable currency was to be the essential factor.[156] So in January 1927 the Reserve Bank bill was introduced in the Legislative Assembly. But British financial authorities were determined to see that such a bank remained sensitive to the demands of India's external obligations and creditworthiness, and was secluded from the influence of Indian 'sectional' or political pressures.[157] Thus, when Sir Basil Blackett, in the hope of gathering political support in India, suggested constituting the Directorate of the Reserve Bank with

some role to be given to non-official members of the Legislative Assembly, whether as electors or ex-officio members, London was furious. Montagu Norman, Governor of the Bank of England, was filled 'with consternation to think that [the] Bank . . . should be in the hands of a Directorate so instituted'.[158] The Secretary of State, Birkenhead, had no intention of giving way on this issue even if he 'could purchase [Indian] co-operation at that price'; the Viceroy, Irwin, in fact suggested that Blackett should resign for even trying to 'prove that the admission of non-official members of the Legislature as ex-officio members of the Electoral Boards was not only unobjectionable but actually desirable'.[159] Further, the setting up of the Reserve Bank required adequate reserves of gold and sterling. Moreover, Indian legislators hoped to amend the Bill so that it would allow the introduction of gold coins in India. Blackett favoured the idea. But Hilton-Young, the India Office and the Treasury ruled it out. For what would Montagu Norman say if India asked for 100 million worth of gold to strike coins. They insisted that the Bill be withdrawn for the moment, though the public reason to be given for it was not the objections to gold coinage but to deep differences over the constitution and composition of the board of directors. This was done in September 1928.[160]

With the onset of the Depression, while the British balance of payments position became critical and the financial crisis gripped London, Delhi was faced with an economic and political crisis of the first magnitude. The drastic decline in India's export earnings, fall in government revenues, and collapse of foreign confidence in the rupee together made an Indian default in London a real possibility, and thereby threatened the security of British investments as well as the fortunes of the pound sterling. At all costs, irrespective of the economic and political consequences in India, the government in India had to prevent a default on her sterling obligations. When sterling was finally forced off the gold standard, the rupee was put on a sterling standard at ls.6d. This meant a devaluation against gold, and the massive flow of that precious metal from India finally gave some respite to London. It was only after the financial crisis had subsided that initiatives for a constitutional settlement in India were revived. (The dramatic events pertaining to Britain's defence of her financial stakes in these tempestuous years, including the question of whether the export of Indian gold to London was consciously encouraged by the authorities, are discussed in chapter 7 below). But even now, as noted above, London remained

committed to maintaining strict control over India's financial management. This meant that there was to be no real compromise with Indians where it affected the 'sound financial administration' and credit of India; all currency and exchange matters were kept under strict viceregal control pending the establishment of a Reserve Bank so insulated from the pressures of Indian politics that, even if there was to be a 'black Finance Minister', he could do no harm to the 'White Man's' Reserve Bank.[161]

These developments in London's India policy converged with the attempts to fashion a new commercial and financial structure for Britain's economic relations. The Ottawa Agreements and the creation of a viable sterling bloc were part of the new economic strategy based on the empire. The establishment of new Central Banks in Canada, New Zealand and India in the 1930s were seen, as Sayers notes, as a step in the re-establishment of international monetary co-operation within this more restricted compass. The Bank of England and its Governor, Montagu Norman took keen interest in their functioning. Osborne Smith, the first governor of the Reserve Bank of India, was a Norman protège.[162] India's role within the sterling area continued to be seen, however, in traditional terms, and primary importance remained attached to the Government of India meeting its sterling obligations. The Reserve Bank was to oversee this, and Osborne Smith was fully expected to strive to maintain the ls.6d exchange: in particular, no quarter was to be given to the demands of Indian businessmen or others.[163] An orthodox restrictionary fiscal and monetary policy on the part of the Government of India was seen as an essential component of this exchange-rate strategy, and the implacable hostility of the finance member of the Government of India, Sir James Grigg, towards Indian capitalists ensured that personal predilections stayed in line with doctrinal ones.

British investment in the private sector: Expatriate and metropolitan

Until the outbreak of the First World War, British metropolitan and expatriate capital, along with the complex operations of their managing agency houses, dominated the 'organized' sector of the Indian economy in external trade, finance, transport as well as extractive and manufacturing industries. Their activities were spread throughout the subcontinent, although most substantially focussed in eastern India. British enterprise in India was characterized by a high degree of interlocking

of boards of directors, and concentration of control in the hands of a small number of managing agencies. This helped co-ordinated actions relating to price and market-sharing agreements amongst different British firms. Moreover, British expatriate businessmen were a well-knit interest group with close personal ties with the bureaucracy, born of cultural and racial affinities, and they derived considerable benefit from these. They might have gained from a more active tariff policy, especially where they were involved in domestic-oriented manufacturing (paper, cement, sugar), but by and large their interests did not clash much with the priorities of imperial policy, concentrated as they were in those segments of Indian industry, trade and finance which were geared to the foreign rather than the Indian market.[164]

Between the two World Wars British investment in the Indian private sector showed a marginal rise in nominal terms, from £ 185 million in 1921 to £ 218.3 million in 1938 (new sterling issues in this period were mainly in loans to the Government of India).[165] A.K. Banerji's estimate of private foreign capital in trade and industry shows a total of Rs 302 crores in 1921 and Rs 412 crores in 1938; of this the British share was Rs 240 crores in 1921 and Rs 302 crores in 1938. His estimates of British held rupee investments show a small rise from Rs 139.36 crores to Rs 155.33 crores over the same period. Rrupee investments controlled by the expatriates declined in jute mills (-2.53 crores), cotton mills (-3.03 crores) and coal mines (-1.43 crores) and rose in electricity and telephones (+9.14 crores), engineering (+3.32 crores), tea plantations (+2.04 crores), railways (+74 crores), sugar mills (+0.72 crores) and miscellaneous enterprizes (+0.72 crores)—an overall increase of 15.97 crores.[166]

While there is little evidence of large-scale capital withdrawal from India (most of the repatriation was on public account), one can reasonably conclude that, over the period as a whole, the India-based British groups had lost dynamism, and they appear to have made very little new investment. Although British expatriate businessmen did venture into some of the newer fields, such as telephones, electricity and civil engineering, and set up some insurance and investment companies, this was not a particularly marked trend. In fact, their overall passivity with regard to import substituting industries was particularly noticeable during the 1930s, when by contrast Indian business groups displayed greater vigour, consolidating their position in cotton textiles and iron and steel, as well as expanding in directions which had

been British dominated—paper, cement, sugar, jute.[167] But despite the changing and uncertain political and economic context, which made expatriates hesitant in diversifying their activities in India and in successfully resisting inroads made by Indian capital,[168] they concentrated on reinvesting their profits in existing lines and continued to maintain their position of dominance in their traditional areas, i.e. jute mills, tea and mining, and their near monopoly in external finance and shipping. Some of the British banking firms had turned to domestic finance as well, and in the 1930s the new manufacturing subsidiaries set up by British-based corporations became important customers of the services of the exchange banks. Altogether, in spite of the increased activity by Indian businessmen in 1939, the 'modern' sector of the economy was still dominated by British firms and managing agents. Concentration of control through mergers increased, and *ententes* among British firms helped maintain reasonable rates of profit.[169]

The period as a whole may not have been the happiest years in the career of expatriates when compared with pre-War times, but business in India was still considered an attractive, fruitful venture, worth the exertions necessitated by a changing environment. From the late 1920s, close observers of the emerging trends in the world of Indian business and politics among the expatriates began to see the need to review their mode of economic operation and their political attitudes for the sake of staying on. Sir E.C. Benthall, possibly the most influential expatriate businessman with close connections with politicians in Delhi and London, for example, contemplated going into partnerships 'with some rich Indian groups (politics may make this desirable), always keeping the master hand myself . . . '. Retreat from India he was willing to consider only as a 'last resort'.[170] Indian politics, he calculated, could still be manipulated through an extension and improvisation of the collaborative strategy of imperial control:

> we may have a gigantic Hindu bloc against us but we have potential allies in the Mussalmans and the States and even with a Labour government and with a further swing of opinion against imperialism and towards nationalism I am confident that India will remain within the Empire, and the greatest of Great Britain's customers, and the cornerstone of our Empire. Granted a period of peace and granted this solidity of India, nothing can prevent the country going steadily ahead as a field for merchant adventure'.[171]

By the early 1930s, as recounted in some detail in chapters 7 and 8

below, the potential radicalism of political movements in India had inspired the slogans of economic 'co-operation' and political 'goodwill' with a special appeal for major figures in the business communities of both countries, whatever mutual suspicions they may still have harboured. From now on, Benthall strongly advocated involving Indian businessmen more closely in expatriate industrial and financial ventures without relinquishing corporate control where possible, but even through mergers and market-sharing schemes where necessary, and to Indianize the technical and supervisory staff of British firms.[172] The Bird-Heilger group, headed by Benthall, pushed ahead with these initiatives, calculating that a crystallization of common economic interests with Indians would provide an effective long-term insurance for the future prospects of his enterprises. These efforts were attended with some success, and were emulated by others as well (e.g. in the case of the cement industry), though by and large Indian interests were still kept away from sharing control in expatriate enterprises.[173] More immediately, alongside the attempts to build economic bridges with Indian businessmen, Benthall led the expatriates in support of a constitutional settlement that would make certain concessions to Indians and modify London's system of control over Delhi.

But the conciliatory moves of the 1930s cannot be seen as calculated insurance for expatriate enterprises whose leaders were readily agreeable to more drastic changes in India's political-economy. These moves *did* prove useful during and after the Second World War, when Britain was forced by Indian politics to quit India; sometime after India's independence Benthall could write in a self-congratulatory vein:

> 'Looking back, I have no doubt that the policy followed by the leaders of British business throughout this anxious time was right, for the responsible line we took leading up to the Independence capped of course by HMG to grant that Independence, prepared the way for the fair manner in which the Congress has dealt with us when they came to power.[174]

But in truth there is little evidence to suggest that before the Second World War expatriates had no stakes left in the future of the British empire in India. In the early and mid 1930s, the conciliatory approach advocated by men like Benthall was combined with a hard fight for effective 'safeguards' against commercial discrimination by Indians. Benthall, moreover, actively engaged with his friends in the Conservative Party in London, devising schemes of Federation and Provincial

Autonomy, along with the systems of electoral reservations and nominations, and in gathering support for these from those sectional Indian interests whose weight in Indian politics had itself been substantially contributed to by the operations of imperial rule. These schemes—which were ultimately the most significant features of the 1935 constitution—Benthall was convinced, would debilitate the anti-British movement in India sufficiently for British power to survive as the ultimate guarantor of expatriate interests.[175]

This period also witnessed the entry into India of over twenty mainly British-based large-scale international firms (such as Unilever, Guestkeen Nettlefolds, Metal Box, Dunlop and ICI).[176] In contrast to the generally timid response of the expatriate firms, these metropolitan multinationals set up manufacturing subsidiaries to cater to the relatively buoyant local demand for a range of sophisticated intermediate as well as certain kinds of consumer goods. Their enterprises in India may not have been of crucial importance for their overall fortunes, but clearly India was an attractive investment proposition. Her attraction lay not only in the structure of her tariffs as it had emerged, her cheap labour and changes in the Government of India's purchasing policy, but also in the long-established commercial and technological links between the two economies on which they could capitalize. These dynamic firms, equipped with new manufacturing and management techniques, initially used the expertise and services of British expatriates, but soon successfully established their own efficient and vertically integrated sales and marketing networks, though the exchange banks remained an important source of short-term financing.

Barring two areas—soap and aluminium goods manufacture where they competed with domestic producers—these British subsidiaries did not by and large threaten the import substituting aspirations of Indian capital in the 1930s. And like the metropolitan exporters of the 'newer' goods of British industry, they could present their interests as consistent with 'India's natural industrial development'. In fact, Indian capital, in view of its somewhat stunted growth in a backward colonial economy and subject to long-term financial and technological constraints, might well have looked upon these agents of advanced capitalism as potential collaborators for its rejuvenation and further development. Despite some differences of opinion, most Indian businessmen were far from adverse to some form of collaboration with such foreign capital as long as they shared a certain measure of control. But while the subsidiaries would stand to gain from overall Indian industrial expansion and from a separation of 'politics' from 'economics', until the outbreak of the Second World War the doors to Indian participation in their ventures remained closed. The Government of India's refusal to make some form of Indian partnership a condition for their operations in India increased resentment among Indian businessmen, already agitated with Sir James Grigg's hostility towards their demands for changes in domestic monetary policies. Moreover, by this time, most of them had come to recognize the need to keep in line with the political priorities of the Congress. This powerful opponent and rival of the Raj now clearly appeared the best body which could be made to help them secure the place they desired in India's political economy. So, despite their ambiguous attitude, they joined nationalist opposition to the new forms of foreign penetration.[177] It was only after the Second World War, when Indian independence seemed imminent, that Indian businessmen felt less inhibited in expressing their keenness for foreign collaboration.[178]

On the other side, although from the early 1940s onwards the multinational firms increasingly advocated transfer of political power to Indian hands in a manner that would not damn their fortunes, they did not until 1939 feel much pressure to change their style. They felt secure enough under the checks provided in the constitution of 1935 against 'discrimination' and in London's acknowledgement that 'those who have invested vast sums in commercial undertakings in India . . . are entitled to look to British Government, so far as may be practicable, that in the future their investment will not be jeopardized by a breakdown of administration'.[179]

The Political Economy of the Raj

In 1913 the Indian empire was solvent, secure, and at peace and the Raj could justifiably appear satisfied with the state of its affairs. Despite strains, it felt confident in its ability to serve the wishes of both metropolitan finance and commerce by keeping its commitment to budgetary orthodoxy, protecting the ratio of the rupee to sterling, and preventing the erection of tariff barriers. But the First World War accelerated many of the trends in the Indian political economy that pointed in new directions. It gave a fillip to the nationalist aspirations of substantial sections of Indian society, encouraged a certain level of import substitution, and burdened the Government of India with unprecedented revenue difficulties. In the two decades following the War,

these Indian circumstances, combined with changes in the world economy, interacted in complex ways to throw into serious crisis many of the cardinal principles upon which the security and solvency of the imperial system had been founded. By the 1930s, political and economic change in their domestic and international dimensions had gone far enough to impel the Raj to adapt and reformulate its strategies of governance, as also its modes of reconciling Britain's traditional and 'new' commercial stakes within the limits set by its own exchequer and the paramount claims of metropolitan finance.[180] But despite Britain's changing economic priorities in India and the increasing loss of political prestige and hold over vast sections of the populace in 1939, holding India was considered neither economically unprofitable nor politically unfeasible. Before the Second World War, it is difficult to detect a lack of interest in keeping the flag flying over the viceregal lodge.

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From the middle of the nineteenth century, low taxation had come to be recognized by the Raj as the key to its political security in an alien, 'Asiatic' society.[181] At the same time, its ability to raise revenues was further limited by its commitment to maintain free-trade in India. The financial foundations of the Raj, thus came to rely heavily on land revenue and excise duties on salt and opium. Of these, land revenue was the mainstay, but with the rise in prices, especially marked from about 1890, the share of agricultural output actually collected as land revenue began to fall, and attempts to raise even the nominal revenue rates faced rural opposition led by powerful social groups. Salt duty was always unpopular, and the government risked raising it only in emergencies. Returns from opium, though substantial, were changeable and went into permanent decline after 1912, when its export to China was officially discontinued. Agricultural income was not taxed for fear of alienating notable allies of the Raj in the countryside, while business and salaried incomes were lightly taxed because they affected expatriate businessmen and the higher salaried civil servants. In the decade before the First World War, income tax contributed only 2 to 4 per cent of total tax revenues.[182] Political considerations and a general ideological disposition against progressive taxation, then, left the Government of India with a tax structure that was both inelastic and regressive. These introduced a strong element of precariousness in its ability to underwrite its 'home charges' in London, and to be self-supporting without taxing

British commerce in India within the constraints set by the requirement to keep its budget balanced.

After the 1890s, through most of which the Government of India had been grappling with problems of falling exchange rates and shrinking revenues which threatened the resources with which to meet its financial obligation in London, the opening years of the new century brought in a period of relative stability and prosperity. Until 1914, the transmitted impulses of expanding world trade and production engendered a certain buoyancy in the Indian economy, because there was both an *increase in exports* and an improvement in the external terms of trade. As a result of this, both government revenues and imports increased and, with continuing demand for Indian exports and inflow of foreign capital, the sterling value of the rupee also remained stable. The stability of the rupee and the reasonably comfortable budgetary situation of the Government of India eased the burden of remitting funds to London, as well as permitted it to function with low levels of taxation. It successfully maintained basically free-trade conditions, relying on temporary increases in direct taxes, cutback in expenditure (which usually meant less money for public works), and custom duties to tide over emergencies.[183]

The First World War strained the Government of India's finances to an extent where temporary expedients were no longer adequate for adhering to the tenets of fiscal orthodoxy in the old way. Between 1913-14 and 1920-1, military expenditure was up by 300 per cent and total expenditure increased by 80 per cent. War expenditure necessitated important shifts in the revenue structure, and the government had perforce to enhance customs duties and personal taxes on non-agricultural incomes. Nevertheless, the War left the Government of India with a large debt, over half of which was contracted in rupees and much of this owed to Indian businessmen. In addition, the Reform Act of 1919 devolved land revenues, which amounted to 26 per cent of the Centre's tax revenue in 1920-1, to the provinces. And, from this point on, custom duties became the major source of Government of India's revenues.[184]

One reason why the Government of India was forced to rely on custom duties rather than other domestic taxes was because it was politically the easiest to collect. Personal taxes had already risen from 4 per cent to 12 per cent of total tax revenues during the War, though both its coverage of population and its incidence on even the highest income groups was miniscule. But further increases in these would have

risked alienating Indian businessmen. The latter had contributed heavily to the war loans and borne the major burden of income taxes. Moreover, the disruption of natural trade and imposition of custom duties during the War had afforded some measure of protection to Indian industry for the domestic market. As a result, industrial investment, output and profits reached unprecedented levels during and shortly after the war. This not only meant that India achieved some degree of industrialization, but also that Indian businessmen emerged as a relatively more vociferous pressure-group with ample endowments in favour of tariff protection. *During the War, when tariffs had been raised primarily to bolster government finances, officials had also come to recognize the need for a certain level of industrialization in India to* serve imperial strategic interests, as well as for neutralizing the attractions of an increasingly broad-based nationalist movement for sections of Indian businessmen.[185] On the positive side, the Fiscal Autonomy Convention of 1919 and introduction of 'discriminating protection' in 1923 were the ostensible concessions made to the Indian business community.

But neither the strength of Indian businessmen nor the government's sensitivity to their interests, certainly in the 1920s, need be overstated. The 'big' businessmen, who could be more active and influential at the national level, were not a large body. Their sociology made them susceptible to the pulls of region, community and kinship bonds, and while these did not necessarily prevent them from taking entrepreneurial initiatives and risks, they did keep them internally divided. At the same time the Indian economy, despite certain tendencies to the contrary, continued to be characterized by a significant degree of segmentation of market and financial networks, and this proved a major obstacle to the emergence of an unified class. Thus, in the middle and late 1920s, when they agitated against economic policies moulded by the priorities of the imperial system in India, and even formed a national level organization (the Federation of Indian Chamber of Commerce and Industry, or FICCI) Indian businessmen seemed to remain subject to the pressures of their particularism and factional infighting weakened them as pressure group. Despite common causes the relationship of different sections of this class with the government and with nationalist politics was heterogeneously conditioned by the operation of a diverse number of factors: their socio-cultural histories and political attitudes, personal relationships with Indian politicians and British officials and businessmen, their need for nationalist support in their grievances against government's policies, and at the same time their dependence on officialdom for the maintenance of 'peace' and 'stability' and control over labour militancy.[186]

All these made them far from straightforward in their dealings, whether with the nationalist leadership or the Raj, and Delhi scarcely *found itself helpless in pursuing its own* financial and commercial aims when faced with their agitations and protests. Later (in chapter 4), I shall recount the actual circumstances under which the Fiscal Autonomy Convention and the policy framework of '*discriminating protection*' emerged. With the end of the War ended official interest in building an industrial base in India, and while the Convention turned out to be more a device to secure the Government of India's orthodox budgetary concerns than to serve the interests of Indian capital (its ambiguities allowing officials to say one thing to their critics in Britain and another to those in India), the discussions preceding the adoption of 'discriminatory protection' made it quite evident that this was not going to be a general policy for industrializing India. The method of application of the policy remained piecemeal. The Tariff Boards were appointed on an *adhoc* basis only after the government had decided to entertain the claims for protection by particular industries and they were required to combine the *generally* conflicting aims of protection to industry *and* of safeguarding the immediate interests of the consumer (this was sought to be achieved through differential treatment of non-competing portions of the imported supply, and provided an opening for 'preferences' for British goods). This cumbersome and intricate exercise often militated against providing sufficient protection to local industry, and even where protection was granted it was often for very short periods of time. In any case, the recommendations of the Tariff Boards were not binding on the government, which was predisposed to applying the policy of 'discriminating protection' so gingerly as not to damage important British interests in the Indian market and, overall, Indian industry received minimal encouragement. (Chapter 6 below narrates how pressure from Britain moulded the operation of this policy in the 1920s).[187]

Moreover, the Government of India's response to its fiscal crises was mainly in the form of a deflationary financial policy. The few years of unbalanced budgets accompanied with uncertainty in exchange rates and inflation soon after the War were considered by officials as a real blot on Delhi's reputation for 'sound' financial management. The result

was over-caution, which dictated that the dose of deflation continue despite the return to normalcy in 1923-4 when India's current external account was once again in her favour, and when budgetary balance was restored. (Between 1920-1 and 1928-29, Central Government expenditure fell from Rs 1616 million to Rs 1237 million).[188] This was coupled with a high exchange, achieved and maintained through contraction of currency from Rs. 4.07 billion in 1920 to Rs 3.3 billion in 1929.[189] Together, they squeezed credit and gave a bounty to imports, which offset some of the protection which tariffs may have afforded Indian businessmen. The overall effect of these measures tended to inhibit industrial investment.[190] The friction, caused by the issues of tariffs, exchange rate and money supply, between the government and Indian business mainly served to underline the continuing power of metropolitan finance and industry over Delhi's economic policies. Throughout the 1920s, Delhi was able to manage its finances consistently with the current orthodoxies and priorities of London, and to generally combine this with the defence of Lancashire's commercial interests, the only exception to the latter—the abolition of the cotton excise in 1925—being a response to working-class militancy rather than proof of the Government of India tilting in favour of Indian industry.[191] Even during the changed economic and political scenario of the 1930s heralded by the Depression, when encouraging a greater degree of accommodation with Indian business interests had emerged as the appropriate strategy for the security of metropolitan and expatriate stakes in India, the City's hold on India's financial policy was decisively reiterated, while in the area of commercial policy there is little evidence of any increase in the direct influence of Indian capitalists, and even less so of the 'eclipse' of the Lancashire lobby. In fact the impotence felt by most sections of Indian businessmen in countering the pressure of British interests and prejudices of officials was one major reason behind the development of a relatively greater degree of cohesiveness amongst them, and of closer links with the Congress. This became evident from the mid 1930s, when the latter had emerged as the major contender for political power.[192]

By far the most important economic development after the War, which put increasing pressures on the operation of the imperial system, was the stagnation that set into Indian agriculture. It is by now well documented that, after 1920 and up to independence, growth of agricultural output and real value-added was negligible in absolute terms and negative in per-capita terms.[193] The growth of Indian exports slowed

down markedly; the country's exports of wheat, rice and opium—which had been important in pre-war days—experienced a decline after 1914 and disappeared after 1933-4.[194] The declining per-capita agricultural output also meant that per-capita real domestic product stagnated, or might even have declined despite whatever industrialization that took place. Moreover, after 1926, this squeeze on income was intensified because changes in the pattern of world trade in primary products caused the international terms of trade to move against India. Meanwhile, the government's contractionary financial and revenue policies only served to aggravate the downswing in prices and made them highly vulnerable to the impact of external price fluctuations.[195]

One implication of this stagnation or decline in incomes was the effect on government revenue. A recent estimate suggests that tax revenues kept up fairly well, and may even have increased, as a proportion of national income after 1920.[196] Nonetheless, the relative stagnation of incomes naturally implied a slow growth of tax revenue as well. While the need to placate and co-opt the propertied classes held back expansion of income and wealth taxes, the context of falling per capita incomes was one where extra excise duties levied on mass consumption goods would only have fuelled social unrest.[197] Thus, the increased poverty of India constrained even more the finances of the Raj, and, to the extent that increased customs duties was the only way out, sharpened the conflict between the financial and commercial aspects of its metropolitan commitment.

The other effect of stagnant incomes was on the growth of the Indian market for manufactures, whether of Indian or foreign origin. With some industrialization already under way in India, the degree of competition between Indian industry and staple imports could be expected to increase, and this would even sharpen in a stagnant market. As indeed was the case with textiles, price competitiveness was crucial and high-cost Lancashire goods faced insurmountable difficulties against Indian and Japanese competition (Japan's superior efficiency allowed her to take full advantage of the high rupee exchange rate, and her goods created serious trouble for the Bombay textile industry as well.)[198] Despite stagnation, however, India did offer some potential market growth for certain other kinds of imports. The changes in income distribution implied by growth of industry and commercialization amidst a stagnant agriculture tended to favour groups which had a higher propensity to consume manufactures, particularly durables. This,

TABLE K

Income, Production, Prices, Bank Rate and Money Supply in India, 1919-39

	Gross National Product (R Bill)	*Real Income per head*[a]	*Agriculture production*[a]	*Industrial production*[a]	*Wholesale prices*[a]	*Cost of living*[a]	*Bank rate (per cent)*	Money in Circulation (Rs. Bill) *Rupee Coins*	*Notes*	*Total Money supply including Bank Demand Deposits*
	1	2	3	4	5	6	7	8	9	10
1919	36.53	105	116	107	202	166	5.62	2.94	1.66	
1920	34.72	100	90	115	209	171	6.06	2.64	1.43	5.47
1921	35.76	104	109	118	185	168	6.20	2.49	1.63	
1922	34.63	109	112	117	181	157	6.00	2.35	1.63	
1923	32.63	107	105	99	177	143	6.22	2.38	1.73	
1924	36.43	112	106	129	178	141	6.25	2.37	1.70	
1925	35.74	111	106	133	164	148	5.50	2.24	1.60	
1926	35.54	112	106	151	153	151	4.50	2.00	1.66	
1927	35.05	112	103	171	153	146	5.67	1.92	1.77	
1928	35.02	112	110	136	149	143	6.00	1.84	1.65	
1929	34.00	116	112	170	145	138	6.50	1.58	1.72	4.50
1930	27.21	113	114	154	120	113	5.67	1.32	1.54	
1931	24.08	111	110	162	99	99	7.00	1.31	1.73	
1932	23.14	110	112	175	94	93	5.50	1.19	1.58	
1933	21.92	109	118	166	90	87	3.56	1.14	1.63	
1934	22.81	109	111	188	92	89	3.50	1.07	1.68	
1935	22.99	108	110	203	94	90	3.46	0.93	1.72	
1936	23.83	110	119	237	94	92	3.00	0.86	1.90	
1937	24.66	109	117	268	105	93	3.00	0.75	1.61	
1938	24.89	108	104	276	98	91	3.00	0.58	1.60	
1939	27.35	110	115	280	111	96	3.00	0.63	2.25	4.43

a 1913 = 100.

From R. Goldsmith, *The Financial Development of India* 1860-1977 (1983), Tables 2.1, 2.3 and 2.4 pp. 69, 73, based on data from S. Sivosubramonian, National Income of India 1900-01 to 1946-47'. *Ph. D Dissertation* (unpublished), University of Delhi, *1985; G. Blyn, Agricultural Trends in India 1891-1947: Output, Availability and Productivity* (1966); and Reserve Bank of India, *Banking and Monetary Statistics of India* (1954).

and changes in taste, meant increased demand for certain new consumer goods such as motor cars, household electrical goods and other luxuries. Moreover, the growth of Indian industry offered the prospect of increased demand for capital and intermediate goods whose domestic production was extremely limited. In the changed context of stagnant incomes and decelerating export earnings there were clear limits to the further growth of staple imports, but substantial growth of other manufactured imports could still take place if India's trade were restructured and new complementarities between Britain and India exploited. As many British officials and businessmen realized, the most obvious way of achieving this was by substituting staple imports by domestic production, since this would simultaneously create demand for the 'new' consumer and producer goods and also release funds from the limited export earnings to make such imports possible.[199] *But this was easier* said than done. Traditional metropolitan industrial interests remained powerful enough to insist on the perpetuation of the pre-War pattern of Indo-British commerce against all odds. This persistent pressure made *Sir Basil Blackett reflect ruefully that 'the old habit of regarding the* Empire as a provider of raw materials and market for British [staple] manufacture will die hard.'[200]

During the 1920s, although the pressures grew, it was nevertheless possible to muddle through without any real attempt at restructuring the pattern of trade, and India managed to play its traditional role in Britain's system of international settlements. But with the onset of the Great Depression, all the alarming trends evident during the 1920s came to a head. The value of India's exports fell from Rs 361 crores in 1929-30 to Rs 258 in 1930-1, to Rs 182 crores in 1931-2 and to Rs 153 crores in 1932-3.[201] This cut down her ability to serve as a market for British manufactures, but worse still, in terms of Britain's financial worries in the early 1930s, it sapped India's merchandise trade surplus. (The latter had, despite stagnation in exports since 1925-6, averaged Rs 100 crores; between 1929and 1933-34 it averaged only Rs 40 crores.)[202] This, combined with the adverse effect on the Government of India's budgetary balances consequent upon the decline of custom receipts

from imports (amounting to 44 per cent of central revenues in 1928-9), and a hostile political climate, weakened the rupee exchange and sparked off a flight from it. Sterling became scarce and remittances from Delhi to London uncertain. This coincided with sterling's hour of crisis, and (as detailed in chapter 7 below) London subordinated all other imperial concerns in India and forced Delhi to adopt extreme fiscal measures in defence of metropolitan finance. The Government of India resorted to cutback in its expenditure, but since this was relatively inelastic downward (only falling from Rs 1239 million in 1928-9 to Rs 1146 million in 1933-4), it had to raise custom-duties substantially in order to balance its books, and to further contract its currency to the tune of 271 million rupees between 1929-30 and August 1931 in order to maintain the rupee-sterling ratio and restore foreign confidence.[203] The situation was saved for British finance and the Government of India when the sterling went off gold, keeping the rupee tied to it at the old rate, and the consequent devaluation in terms of gold encouraged its massive exports from India. But the internal deflationary pressures of these years made the downward trend of prices sharper than in most countries and magnified the impact of the Depression on India's agrarian sector.[204] The current value of crop output in British India fell from Rs 10.2 billion in 1927-8 to Rs 4.8 billion in 1933-4;[205] the index number of agricultural prices (1928 = 100) fell to 48 in 1933, while between 1929 and 1933 the index number of Indian export prices declined by 45.4 points.[206] At the same time, the enhancement of customs put additional barriers for high-cost British staple exports to India: Lancashire's piece-goods exports to India fell from 1235 million yards in 1929-30 to 586 million yards in 1932-3.[207]

By early 1932 even the 'City Fathers' came to acknowledge that the Depression had delivered the final stroke to the multilateral basis of international trade and payments, and Britain turned to fashion her own imperial trading and monetary bloc. In the changed context, the relationship that had existed between the British, Indian and the world economies came to be reformulated within which British financial and commercial interests were sought to be reconciled. For the former, India now needed to run a trade surplus with Britain, and for the latter, for the first time a conscious attempt was made to restructure Indo-British trade on the basis of new complementarities under a system of mutual preferences. This strategy, worked out at Ottawa, was inextricably linked with the need to contain agrarian discontent by providing some

support for Indian exports and with the plans for constitutional reform in order to diffuse the anti-imperial energies of Indian politics.

Meanwhile the Depression, despite its serious effects on agricultural prices and incomes, ushered in a decade of relative prosperity for Indian industry. Total 'real' investment in the 1930s remained remarkably stable. (In fact, in 1930 and 1931 total 'real' investment was comparatively higher than in the mid 1920s owing to its rise especially in sugar and paper industries).[208] Industrial output rose by over 80 per cent between 1930 and 1939, and total income in the manufacturing sector (at constant prices) increased by 65 per cent.[209] This somewhat paradoxical phenomenon is explained by the operation of several factors: imports fell substantially owing to the combined effects of the adverse terms of trade and high tariffs; the internal terms of trade moved in favour of industry; changes in income distribution favoured towns, and urban demand for certain industrial goods seems to have expanded considerably. Even in the rural sector, real incomes fell less drastically than the fall in prices would suggest, principally because food became cheaper, while the dishoarding of gold and increased borrowing helped maintain rural demand. After 1932, the Ottawa Agreement revived incomes from Indian exports, and from 1933-4, as the Depression began to lift industrial activity received a further impetus, which attracted certain traditional trading and money-lending communities to move into manufacturing for the domestic market.[210]

All this of course does not indicate that India was being rapidly transformed from a low-growth agrarian economy into a dynamic industrial one. Although some funds were transferred from external trade and agriculture, there was no major change in the overall allocation of capital in the economy. In terms of 'real' investment in the industrial sector, there was no upward trend noticeable in the 1930s, and growth in output was achieved mainly through better capacity utilization. Nor was there any significant shift in the occupational structure of India as a whole. The share of the manufacturing sector in the national income fluctuated between 4 and 7 per cent. Besides, most of the spurt in industry was confined to manufacturing consumer goods such as textiles, sugar, matches and to producer goods such as iron and steel and cement. Barring the latter industries, there was virtually no development of capital goods capacity and there was a general lack of technological innovativeness.[211] Nevertheless, by 1939 Indian industry had made substantial advances in substituting traditional imports with its own products. This development, along with the global changes in

production, trade and payments patterns began to change India's pre-War form of dependence on the world capitalist economy.

In his *Political Economy of the Raj*, Tomlinson argues that the sharp contraction of foreign trade during the Depression not only insulated the domestic market for import substitution by Indian industry but also brought about a structural break in the Indian money market: the decline of Indian exports damaged the 'indigenous' trading and banking institutions which had hitherto linked Indian agriculture to the world markets, and the profits of agriculture were channelled into 'westernized' financial institutions to the advantage of industrial enterprises. These changes, the argument (put sharply) runs, made the Indian economy less 'colonial' and, when combined with the changing structure of the British economy, conspired to lay the *economic* basis of decolonization.[212] Admittedly, the Depression, by definitively disrupting the networks of international economy, rendered the traditional 'colonial' pattern of commercial and financial transactions between Britain and India increasingly untenable. But it is difficult to agree with Tomlinson that India's economic value to Britain basically disappeared, rendering India increasingly redundant for retention within the empire. Structural change in Britain, as we have seen, did not amount to making her external sector unimportant for her well being. Despite decline, India was still one of the largest markets for Britain's merchandise; more significantly, Britain still had substantial financial investments in India, whose security and servicing were a crucial concern because of their importance for various powerful groups, the government's exchequer and for the indispensable invisible account in Britain's weakened balance-of-payments position. The multilateral mechanism of Indo-British trade and settlements might have been irretrievably disrupted, but disruptions in trade and credit networks in India were at best temporary, and structural change in the economy limited, and imperial bilateralism provided an alternate mechanism.[213] The restructuring of the pattern of trade in order to sustain the vital financial flows from India to Britain, necessitated by the changed conditions of world commerce and import substitution in India, was compatible with the considerable immediate stakes and longer-term prospects in India of the more dynamic sectors of British enterprise. The actual attempts made by British financiers, entrepreneurs and policy-makers in the 1930s to establish a new, bilateral pattern of trade and settlements with India, far from indicating India's growing economic negligibility, underlined the continuing importance of securing her role within Britain's emergent imperial autarkic system; the Raj was still the necessary agency for doing so.

Of course the Raj could have better served the prospects of the more dynamic sectors of British commerce, and indeed of imperial interests as a whole, if it had been able to generate higher incomes in India, mainly through agricultural growth, since stagnation in this sector held back domestic incomes and the level of investment in 'modern' industry. Such development would also have replenished the coffers of the government, enabling it to finance its political apparatus and alleviate the miserable condition of the multitudes. Indeed the all-round advantages of agricultural development were recognized by many policy-makers.[214] Agricultural stagnation could be overcome only through massive state investment with appropriate fiscal and monetary accommodation, and would have also required changes in policies with regard to property and tenancy rights. But while the latter could not be carried out without serious political cost, the former measures were constrained by government's inability to raise more revenues, and, more importantly, by the persistent 'tradition of Government in India with regard to finance and development' as Lloyd George had once put it, '[which was] the overcautious one of an old family soliciton'.[215]

In the 1920s capital expenditure was modest, averaging around Rs 27 crores. During the Depression the main burden of its financial economies fell on capital expenditure, and, even after the crisis had blown over, 'sound finance' was reasserted by the ultra orthodox finance member James Grigg with a vengeance. So between 1931 and 1939 capital expenditure fell to an average of Rs 6 crores, constituting less than 1 per cent of the national income.[216] Under these circumstances, attempts at bilateralism under a system of Imperial Preference seemed the only feasible, if second best, option. And if the growing sectors of British industry were unable to reap maximum advantage from the search for new complementaries through the strategy of 'economic cooperation' between businessmen of the two countries, it was largely because of the political complications arising out of the traditional demands of Lancashire. On the Indian side, by the 1930s businessmen could not hope to pursue their economic aims if these were not compatible with the nationalist concerns of their friends within the Congress. And Indian nationalism was allergic to any compromise with Lancashire. On the British side, no government could ignore this still weighty and politically volatile industry. The Raj was charged with the defence of its interests against all odds, and it did it. In the end,

Lancashire's interests may not have been compatible either with the larger construct of imperial aims or with the more specifically Indian construct of political and economic priorities. But until 1939 the dilemma remained unresolved. Cotton was still king, even if its rivals were beginning to raise their claims to its throne.

Notes and References

1. 'Empire was the context of British power: it gave England a dimension and its people their place. They expected to retain it, and the prestige that came with it .... The broadest stone they laid down was India, a foundation both for the security and ideology of Empire'. A.P. Thornton, *For the File on Empire*, pp. 2-3; 'Roots of Jingoism', pp. 265-82.
2. Lord Mayo, quoted in S. Gopal, *British Policy in India* (1965), pp. 120-1.
3. *Ibid.*
4. Saul, *Studies in British Overseas Trade*, pp. 62-3.
5. The process of remittance of funds from India to Britain has been explained in J.M. Keynes, *Indian Currency and Finance* (1913), chapter 2; Y.S. Pandit *India's Balance of Indebtedness, 1898-1913* (1937), part II, and summarized in B.R. Tomlinson, *Political Economy of the Raj* (1979), pp. 17ff. Officials were aware of the importance of India's export earnings for the British imperial system. See 'Views of the Government of India on the Question of Preferential Tariffs; Cd. 1931, *Parliamentary Papers* (hereafter *P.P.*) 1904, LXVII, especially pp. 4-6; J.M. Maclean, 'India's Place in an Imperial Federation', *JRSA*, LIL, 18 Dec. 1903, pp. 81-90; discussion on the paper, pp. 90-5. Maclean was awarded a silver medal for this paper. See also A.K. Bagchi, *Private Investment in India 1900-1939* (1972), pp. 47-9.
6. From the middle of the nineteenth century to the First World War international trade was characterized by a vertical specialization between primary producing and manufacturing countries within the system of Free-Trade and Laissez-Faire, such specialization being seen by many as constituting a strategy of international economic growth and 'development'. To be sure, the expanding international economy of the nineteenth century did provide possibilities of growth to many primary producing countries such as Australia, New Zealand, and South Africa. However these countries were endowed with special advantages which enabled them to reap the gains from foreign trade, most importantly the abundance of cheap and fertile land and the ability of the immigrant population to utilize technological changes and rising incomes of the industrial countries for their own growth. Moreover, the white settlers from high income, high productivity countries were able, for a variety of reasons, to set up political systems which enabled them to acquire a certain level of autonomy from their mother country, and to

implement policies of state patronage, including tariff protection. Even for these white dominions, however, freight rates etc. cheapened imports, and the foreign exchange rate, which tended to reflect the competitive strength of the favoured sector, gave little encouragement to the development of indigenous manufacturing. This is not the place to go into the question of how economies evolve, but it does not seem particularly surprising that a similar development did not take place in India, given the very different initial conditions. Exports grew to the extent that they did substantially as a result of reallocation of resources, rather than through the bringing into use of abundant and previously unused resources: the consequences for GDP growth and *pro tanto* the consequences in terms of growth of internal demand for manufactured products were therefore much smaller.
Any major breakthrough in agricultural output would have required a combination of radical land reforms, massive public investment and/or critical technological breakthroughs, none of which could be expected to come from the farm sector itself without active government intervention. But such intervention a colonial government, facing an alien society, could neither afford nor risk. Furthermore, the system of 'discriminating laissez-faire', adopted by the colonial government to encourage specialized production in India for the international market, also further limited the gains from such specialization. The railways, for example, built to serve the interests of international trade, and military and administrative needs, had little effect on the integration on the national economy. Similarly, public expenditure in India, notably in the railways, benefited metropolitan manufacturing interests (who actively influenced the Government of India's refusal to encourage an indigenous locomotive industry). The economic liberalism of free trade and 'discriminating laissez-faire' was, in the words of one scholar, 'hardly distinguishable in its end effects from mercantilism', and arguably contributed to the lopsided development of the Indian economy and its legacy of regional differences colouring the political economy of the country. Private foreign enterprise in India in plantations and extractive industries gained many concessions from the government; these had few positive effects for the indigenous population. These arguments are well known, but see S. Bhattacharya, 'Laissez Faire in India', *IESHR*, II 1, (1965); D. Thorner, 'Great Britain and the Development of Indian Railways'. *JEH*, XI, 4, (1951) and 'The Pattern of Railway Development in India', *FEQ*, XIV, 2 (1955); F. Lehmann, 'Great Britain and the supply of Railway Locomotives to India: A Case study of "Economic Imperialism", *IESHR*, II, 4, (1965); John Hurd, 'Railways', in D. Kumar (ed.), *Cambridge Economic History of India*, II (1982), hereafter *CEHI*; R. Nurkse, 'Some International Aspects of the Problem of Economic Development; *AER*, XL, 2, (1952); H.W. Singer, 'The Distribution of Gains between Investing and Borrowing Countries', *AER*, (Papers and Proceedings, May 1950). The