

Independent India and the Secret UK-US Deal That Changed It All

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How India's dream of using her wartime loan to finance development went up in smoke.

A sea change, with many long term consequences, took place in the US view of India between 1944 and 1947.

By the 1940s, India had many friends in the US. Important members of President Franklin D. Roosevelt's administration, including vice president Henry Wallace, secretary of state Cordell Hull, presidential assistant Lauchlin Currie and state department political adviser Wallace Murray, lobbied strongly for India, as did the conservative Republican Congresswoman Clare Boothe Luce.

Roosevelt himself pressed Britain for Indian independence. Henry Wallace exposed British responsibility for the Bengal famine. Republican Congressman Karl E. Mundt worked with Democrats to pass US law (PL 267) that would enable the United Nations Relief and Rehabilitation Agency to provide food assistance to India, though this was eventually prevented by the British refusal to allow it.

All this led Indians to believe that the US might influence Britain to repay her enormous wartime debt. In 1939, Britain stopped the convertibility of the pound sterling. Countries that exported goods to her could not remit the proceeds. These amounts, and the contribution, voluntary or otherwise, of various countries in the British Empire and Commonwealth to Britain during the War, comprised the blocked sterling balances of £3.35 billion.

India's share of these by 1945 was about 45%, or £1.51 billion - the equivalent of \$83.93 billion today. This was by far the largest of any country. India's balances were made up of £546 million of her export earnings, largely to the US, held back in London, and £969 million withheld payment for the Indian contribution to the war, which included paying for the largest volunteer army in history, supplying food, munitions, military vehicles and other equipment to the Allies, including China.

The Indian government financed this by increasing taxation (by 1945-46 it was three and a half times what it had been in 1939-40), and expanding the money supply so that Rs 10.78 billion - 27% of the money the government raised - was financed by using this method. By 1942-3, Indian inflation rose to 70%.

Both Jeremy Raisman, finance member of the Government of India, and RBI governor James Taylor had undertaken that after the War these blocked balances would be refunded and be used for development. Accordingly, Jawaharlal Nehru was left to believe that this was possible (*Discovery of India*), and the Bombay Plan set out by India's leading businessmen earmarked these funds to finance industrialisation.

The White Plan for the Bretton Woods institutions worked out a mechanism whereby the Fund, underwritten by the US, could unblock these balances. For long, Britain [emphasised her obligation](#)

[to repay India](#) because it strengthened her case for US relief. But with the introduction of a specific programme to do so, British official circles were alarmed. Officials [argued](#) “that if the plan is adopted financial control will leave London and dollar exchange will take the place of sterling exchange”.

Accordingly, the important British adviser John Maynard Keynes set out to lobby the US administration to substitute Harry Dexter White’s transparent multilateral policy with secret bilateral negotiations with each country so that they could not ally with each other. This would give Britain greater control.

He succeeded. The White Plan was abandoned. At the Bretton Woods conference, India and Egypt attempted to raise this issue but were voted down by an alliance of the UK, the US and France.

Yet the issue resurfaced. The Anglo American Loan Agreement of 1945, ratified by Congress in 1946, provided the UK \$3.75 billion but [stipulated](#) that the pound sterling would have to become convertible on the current account by July 15 1947.

So the Indian and Pakistani delegations negotiated with Britain in London on the sterling balances in 1947 on the assumption that periodic instalments would be repaid in convertible currency. According to the interim agreement concluded in London on August 14, 1947, between the UK and India and Pakistan, £35 million was released as the unblocked balance for the remaining four months of 1947. But the bulk of the balances of £1,160 million were to be subsequently released in annual instalments that would be negotiated in the next round.

Yet the Indians did not seem to have noticed how much things had changed. India-sympathetic US Cabinet members had all resigned or been sacked by Roosevelt’s successor Harry Truman, even as Britain became the principal US ally in the Cold War. The very agreement on which India had counted was threatened.

The Bank of England had already prepared to renounce the convertibility that the Indians and Pakistanis counted on. By April 29, several months before the British met officials in London, they were already working out how to avoid repaying India’s outstanding sterling balances; by June 23, a note had been circulated in the Bank of England discussing how convertibility might be suspended. By August 8, the Bank of England finalised the modality of the suspension of convertibility, deciding that Wilfred Eady, who was at the very moment negotiating with the Indians, after winding up the negotiations on August 15, would immediately go to Washington to coordinate with the Americans.

As it moved closer to defaulting on convertibility, Britain kept the US informed, and Lewis Douglas, the US Ambassador in London, [lobbied](#) for them to do so. Even before negotiations began with India and Pakistan, the UK [secretly proposed](#) to the US not repaying them or making her balances inconvertible.

As soon as convertibility came into force July 17, 1947, Britain threatened that were she weakened by having to repay the sterling balances, she would not be able to provide the leadership that alone would prevent Western Europe from turning Communist and the US Ambassador believed [this to be true](#). Finally as Britain embarked on default, she [alerted](#) the US as to the precise date. By the next day, August 19, the precise wording in the exchange of letters that would follow between the two sides had been [worked out](#).

So convertibility only lasted for a little over a month. It began July 17, 1947. It was revoked on August 20, 1947, five days after the agreement was signed with the largest creditor, India - the day before Indian independence. This technical default on the Anglo American Loan Agreement actually

had the effect of simultaneous default to those countries that held sterling balances that they expected to convert to gold or US dollars.

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I have earlier [pointed out](#) how this default enabled London's post War revival as the global centre of finance.

But this change in US policy toward India was to set the stage for further developments. On April 4, 1949, secretary of state Dean Acheson heard British foreign secretary Ernest Bevin on how the US should deal with the Middle East and South Asia. Bevin's advice, which Acheson took seriously, was that the central concern was oil, and to safeguard that oil, an alliance with Muslim Pakistan was all-important, not India.

This was echoed by the US Joint Chiefs of Staff report: "From the military point of view, the countries of South Asia, excepting Pakistan, have little value to the United States... ('A Mission without Success', *Frontline*, May 21, 1999)". Accordingly, prime minister Jawaharlal Nehru's visit to the United States in October 1949 was met with a cool reception (*Inside the Cold War*, Brands H.W. 1991). After Stalin's death in 1953, India built up her relations with the Soviet Union, a process that culminated in the Indo-Soviet Treaty of Peace, Cooperation and Friendship of August 1971.

Kannan Srinivasan

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