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THE RATIONALISATION

OF MONEY

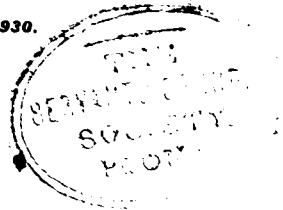
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BY
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APPENDIX I. (A)

THE STABILISATION OF SILVER—PART I. *

MAIN REASON FOR THIS SUGGESTION.

Almost despairing of the possibility of stabilising the long-period value of gold¹ and finding it increasingly impossible to bring about an equitable distribution of world's existing gold stock² drastic and radically novel proposals³ are being suggested by economists, laymen, and the vested silver interests to artificially raise the value of silver by sheer force

* Paper published in the *Indian Journal of Economics*—July 1932.—

¹ No serious attempt has been made thus far to grapple with this problem at least on the lines recommended by the Genoa Financial Conference of 1922, nor have the recommendations of the League of Nations Gold Delegation Committee been carried out by the different gold-using countries. The recent suspension of the gold standard by the United Kingdom on September 21st 1931 followed by other countries has made the possibility of making gold an international standard a very remote contingency. Sterling is pitted against gold and the attempt of the British Currency experts is to provide a solid proof of the stability of the pound sterling as against the gold. But a time will come when it will have to be attached to a standard. Perhaps the moral triumph of the "tabular standard" which is so ardently preached by every Marshallian is about to become an accepted fact. It is quite likely that "the laissez-faire hard shell gold bugs" will not succeed for there is a determined attempt being made by the Empire Economic Union to have a big Empire Central Bank of its own and settle the Dominion Exchange problems with its help.

(²). Both America and France refuse to play the game of the International Gold Standard. As creditor countries they refuse to lend long and they do not allow their gold to upset or even influence their price-level. Gold is sterilised or bottled up with the effect that the American or the French price-level does not rise and bring about an international current of the inflow of goods. Gold must be lent to the countries of the world cheaply, easily, and freely to secure currency stability in these borrowing countries. The Federal Reserve Board is now raising the Bank rate to check the outflow of gold from the American Banking system on the plea that its free stock of gold as compared with the short term indebtedness does not permit her to view with equanimity the gold drains.

(³). See my article on "Remonetisation of Silver" published in the *Indian Journal of Economics*, July 1931. See Appendix I.

de majeure. It is not, however, understood by these enthusiasts that artificial prices setting at naught the natural governing forces of demand and supply would be a menace to economic stability in the long run. Governmental intervention is being sought in the direction of raising the gold value of silver from the present-day natural low level to the highly artificial and theoretical level of 30*d.* an ounce.¹ The average price of silver as determined by the few figures available with reference to its price during 1927 to 1931 is far below the same which prevailed during the previous years prior to the recent war. The stable pre-war price was round about 30*d.* an ounce roughly. So the proposals are to delightfully raise the value to this particular level which will be greatly appreciated by the European, the Indian and the Chinese people. Obviously it would bring profit to the silver-producing interests of North America and Mexico* for the Governments which are parties

¹ See Hon'ble (now Mr.) L. S. Amery's article on the Rehabilitation of Silver in the *Commerce* November 5, 1931.

² In July 1931, Mexico literally abandoned the Gold Standard although nominally it has retained the gold peso.

*The following table shows the chief silver producing countries and their annual output. See the Statistical Year Book of the League of Nations, p. 142.
(in kilograms)

Continent.	1923.	1924.	1925.	1926.
Africa ..	72,950	79,700	63,850	60,950
North America ..	28,58,387	26,47,502	26,85,395	26,45,237
Central America ..	29,02,400	29,27,700	32,42,300	34,07,400
South America ..	8,51,500	8,32,700	8,86,400	9,88,800
Asia ..	3,18,400	3,47,400	3,60,000	3,80,000
Europe ..	2,78,000	3,17,400	3,57,000	3,71,900
Oceania ..	3,84,600	2,99,750	3,30,700	3,33,900
Total.	76,66,000	74,51,500	79,25,500	81,88,000
Continent.	1927.	1928.	1929.	1930.
Africa ..	64,700	61,800	66,200	..
North America ..	25,85,704	24,99,593	26,42,407	23,76,400
Central America ..	36,08,000	4,55,500	34,68,000	33,60,000
South America ..	7,92,200	9,04,400	9,12,700	..
Asia ..	4,05,000	4,60,800	4,56,400	4,50,000
Europe ..	3,84,600	3,74,500	3,80,000	..
Oceania ..	3,74,300	3,12,300	3,26,200	3,43,000
Total	82,10,000	80,69,000	82,34,500	7,00,000

to the scheme would be literally carrying the industry at their own expense. The monetary "cranks" are gradually spreading this idea into the minds of many. But before this new idea is permanently approved it must be analysed and studied in all its manifold bearings.

In order to make the public amenable to their suggestions a great many evil consequences are being predicted if the fall in the gold value of silver is not immediately arrested by timely action.

OTHER SUGGESTED ADVANTAGES.

Apart from solving the present-day situation arising out of the maldistribution of gold stock the other distinct advantages which would follow the above timely action, viz., the raising of the price to 30*d.* an ounce, can be briefly stated to be as follows. Trade with silver-using countries like China, Mexico, and India would be greatly hampered as a result of further fall in the gold value of silver. As the value of their exports is cut down their own capacity to import foreign goods is correspondingly reduced to the value of their exports. "Exports pay for imports" is the most classical economic theorem which needs no elaborate proof here.

Nextly, the free introduction and investment of foreign capital in the silver-using countries would be jeopardised. Steadily-falling silver in the last seventies of 19th century acted as a severe handicap to the free, sober and reasonable investment of capital in the silver-using country. A similar situation would arise.

Governmental instability in the case of all the silver-using countries would be the inevitable result. Fast falling silver money means unexpected budgetary complications as the silver-using countries have to pay interest on their loan amounts in gold. The Central and South American Governments have been anticipating serious financial and political complications under this score.

Lastly, the value of the silver hoards would be cut down in due proportion to the fall in the gold value of silver. One modest estimate that has been recently framed is that these hoards have already lost 60 per cent. of their pre-war value. These financial reserves, if at all they exist,¹ would have to be sold at reduced value when the occasion or compelling necessity arises to sell them.² In short, the prognostications of these pessimists foreshadow that the economic development of the silver-using countries would be gravely handicapped.

Hence the "currency cranks" are exercising their ingenuity in devising new apparently plausible schemes to rehabilitate the value of silver. But the future price of silver may not be such smooth and plain sailing as these enthusiasts think or calculate it to be.

THE ARTIFICIAL PRICE OF 30*d.* AN OUNCE.

An interesting case is being made out for the acquisition of silver at the theoretical price by the Governments of the chief silver-using countries such as India³ and China and the Governments of the United States of America, and the United Kingdom. The silver-producer is to be protected and compensation has to be paid to him by the general tax-payers of these countries. The historical example of the U. S. A. Government's purchase of great stocks of silver at a high rate

¹ Of late, there has been a remarkable change in the monetary habits of the people. The shifting of Indian silver reserves into gold is a comparatively noticeable phenomenon of some importance in this direction. Secondly, the existence of widespread poverty along with these silver hoards cannot be reconciled as pertinent truths. The national vice of hoarding is nothing but an exaggerated myth and delightful schemes cannot be based or safely adumbrated on fabulous myths.

² See the Evidence of Sir Charles Addis and the Right Hon'ble Mr. Montagu Norman in this respect before the Hilton Young Commission.

³ The plan of the International Chamber of Commerce is to sell silver at a very high price to the Government of India. It tacitly recognises that any scheme for the uplift of silver that does not include India is bound to be a tacit failure. Similarly if the Government of India were to sell silver at a price below the artificial price this would tend to drag down the price of silver.

in the last seventies up to 1893 is generally adduced in favour of this measure.¹

ECONOMIC FRICTION.

This measure cannot however appeal to any clear-thinking economist. It requires these different Governments to go into business on a grand scale and it would probably involve immense wastes if the scheme is not carefully carried out.

Even granted that it is carefully carried out, the present-day difficulties would be intensified by perverting the price mechanism and bullion market machinery. A little elucidation of these points would be needed to enable the reader to grasp the real practical points at issue.

INTERFERENCE WITH PRICE MECHANISM.

The silver producers now find it difficult to sell the mined and "by-product" silver specially in a market where the demand for industrial use alone is prominent. The recent demonetisation of silver, even for subsidiary coinage purposes has completely changed or altered the demand factors for this metal. Seventy-five per cent. of the total silver production was formerly used for monetary purposes and twenty-five per cent. alone was absorbed in the arts. Silver was more a monetary metal than gold for more than thirty per cent. of

¹ The Bland-Allison Act of 1878 was the first silver purchase law of the U.S.A., Silver bullion, whose value was not less than 2,000,000 dollars and no more than dol. 4,000,000, had to be purchased every month and coined into silver dollars and added to the monetary circulation. Between 1878 and 1890 the U. S. A. Government purchased the minimum quantity monthly and roughly dol. 352,000,000 were added to the monetary circulation. The famous Sherman Act was passed in 1890 and was in force for a period of three years. The U.S.A. Government had to acquire monthly 4,500,000 ounces of silver. About dol. 218,000,000 were added to the circulation. The price-level did not however respond quickly to these additions of purchasing power. The silver inflation however kept the American price-level about the world level and tended to drain gold out of the country. The financial panic of 1893 in the U. S.A. led to the repeal of the silver inflation measures.

gold's demand arises out of industrial use and roughly two-thirds of the gold output alone is used for monetary purposes.¹

Now that monetary demand for silver is being given up in India, in the Eastern countries and in Siam the excessively high stocks resulting out of unabsorbed silver bullion cannot be disposed off at the theoretical price. This great discrepancy between the theoretical price and the natural price cannot be checked all of a sudden. So the slow and painful process of Governmental purchase or block-purchase by a Silver Syndicate² is recommended to enhance the market value of silver.

The U. S. A. and the United Kingdom and Indian Governments are to store this silver secured at a high price and use it for subsidiary token coinage purposes. Mere hoarding like a proverbial miser gloating over his stocks of precious metal will not be of any great avail. The deriving of mere psychological and aesthetic pleasure in holding comparatively large stocks of silver will not be a significant thing or advantage.

POSSIBLE INCREASED OUTPUT OF SILVER.

Under the conditions of Governmental block purchase at the high theoretical price the silver output might be stimulated. No attempt will be made to discover diversified uses for silver. It cannot be considered as a mere emergency measure for silver stock is becoming too great even for all the present-day uses. The increased stocks will result out of

(1) The Gold Delegation estimates the total demand for non-monetary purpose at about \$ 200 millions per annum out of a total of \$ 400 millions and the balance is generally utilised for monetary purposes.

(2) It is announced in the newspapers that a London Silver syndicate is acquiring 600 mil. ounces of silver from the Secretary of State for India. The object is to unload it slowly at a greatly enhanced price, viz., at 15 per cent. higher price than the present-day market price. This reminds us of the Syndicate which purchased the unsold silver stocks of the cornered commodity of the late Mr. Chunilal Saraiya and the successful way in which it unloaded the silver stock. But times were undoubtedly propitious then as the Governments were making good use of silver for subsidiary coinage purposes. Such daring marketing manoeuvre cannot be immediately successful in a market where the monetary demand has altogether been given up or forsaken.

(a) "the mined output which might be stimulated as a result of the very paying prices" at which Governments would be forced to acquire silver; (b) the by-product silver would also increase to secure this enhanced price; (c) the released silver coinage hoards which would be sold off at this high theoretical price to the above Governments.

The reduction of output of silver will not take place under the above scheme. The plan itself would have to be stretched over a ten-year period and might be forced to become a permanent one. Government funds would always have to be wasted on the somewhat barren undertaking of raising and steadying the price of the glut of silver products, both mined and by-product silver as well. Even granted that silver mining down to the last marginal miner can be effectively controlled by the Silver Selling Syndicate the millions of by-product silver cannot be satisfactorily dealt with so long as these base metals—lead, copper and zinc—are produced. The released stocks of Governmental silver would flood the market. The economic law of the doctrine of value concerning composite supply cannot be broken with impunity.¹ Unless and until the production of other metals is restricted there would be no diminished production of silver to satisfy the decreasing demand in the world market.

MEDDLESOME INTERFERENCE.

Barring a temporary fillip and a restoration of confidence in the value of silver no permanent raising of the price-level to the theoretical level of 30*d.* can be secured. Acquisition at a higher price stimulates silver production. More

¹ This law says that when two products are being produced jointly the fall in the value of one must be compensated by the rise in the price of the other product so as to cover the cost of production such as mining, smelting, refining and transportation to market. Silver, zinc, copper and lead are produced and if the value of silver were to fall the value of copper, lead, and zinc should rise. If silver is allowed to fall in value more money must be paid for copper, zinc and lead if their use is desired by the leading industrial nations. See F. H. Brownall's Address before the Mineral Law Section of the American Bar Association, Atlantic, City, Sep, 16, 1931.

by-product silver means more of the jointly produced metals as copper, zinc and lead. These would have to be sold at lesser price than at present. Their price has to be depressed to that level which just pays the mining business. If this were not to be the case the increased profits under the enhanced price of silver and the profits under the jointly produced metal would be too tempting to be resisted by the producers. There would literally be a surfeit of four metals under this scheme. The scheme of "boosting" up of the price of silver might inevitably lead to the Governments getting out of business if they were to saddle themselves with such an undertaking. Ultimately, in my judgment, a period of ten years would make the situation worse and more confounded than at present. A worse situation will have to be faced by the silver-producers. The price mechanism of as many as four conjointly produced metals will have to be tampered with in order to realise this cherished consummation. The prices of these metals are now being determined in the open competitive market under a regime of "free enterprise and private property" as the economic jargon would put it. Stocks of these metals are being ruled in the long run by prices prevailing in the market. The economic function of the market price is to tend to restore industrial balance in the matter of production. This is the pivotal base of economic activity not only in mining but in any field of human enterprise.

ARBITRARY CONTROL.

The socialistic notion of controlling the consumption and production of four metals, silver, lead, copper and zinc, is bound to fail unless there is an elaborate and scientific planning of the most exact kind. It would involve the control of many other activities of the people on the part of these silver-producing and silver-purchasing Governments. The final up-shot of this course of action would be that a vicious circle of arbitrary Governmental activity involving almost a world-wide control of markets would be initiated. The

scheme is bound to collapse just as all other schemes for cornering the silver and copper metals proved illusory. The mediæval conception of considering metallic bullion as wealth is an old and downright fallacy. Even the man in the street with hardly or any modicum of economic knowledge would not believe it to be the truth.

FIASCO IN PUBLIC FINANCE.

Most of the foreign consumers of silver would murmur at this declaration of the theoretical price in a high-handed manner by the Syndicate of the silver-producing countries. International trade relations would become strained as a result of the unnatural Governmental activity. The Governments have to strain their taxing capacity to gather the funds needed to raise the present-day market price of 17*d.* an ounce to 30*d.* an ounce. A great fiasco in the field of public finance would ensue as a result of this attempt.

CHECK TO INDUSTRIAL USE.

The last and the most formidable obstacle is that a high theoretical price would check the industrial use or absorption of silver by the people. Take China and India, for example. More imports of silver generally take place into these countries as soon as the gold value of silver falls. Similarly when the value of silver rises the industrial use receives a rude check. The following tables¹ concerning the supply of silver and its absorption are highly instructive.

TABULAR STATEMENT I.²

Silver Supply (Millions of Fine Ounces).

	1920.	1921.	1922.	1923.	1924.	1925.
Production	173	171	210	246	239	245
Demonetisation sales ..	44	41	50	41	4	6
Total ..	217	212	260	287	243	251

¹ This as well as the following table are taken from the article entitled "The fall in the value of silver" by F. D. Graham,—*The Journal of Political Economy*, p. 468.

² Compare these tables with those of the *Economist* No. 4590 March 1932 p. 662. The *Economist's* figures are from an unpublished paper of Mr. Joseph Kitchen.

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		1926.	1927.	1928.	1929.	1930.
Production	..	254	254	258	262	241
Demonetisation sales	..	2	25	71	53	71
Total	..	256	279	329	315	312

TABLE II.

Absorption of Silver (Millions of Fine Ounces.)

		1920.	1921.	1922.	1923.	1924.	1925.
Net Imports of India plus domestic absorption of Indian Treasury sales and of home production	..	6	57	72	98	91	105
Net Imports of China	..	113	39	48	82	32	75
New Coinage in Occident	..	40	69	56	57	71	7
Industrial use	..	45	53	58	55	53	59
Total	..	240	218	234	292	247	256
Unaccounted for	..	-13	6	-26	4	5	5

		1926.	1927.	1928.	1929.	1930.
Net Imports of India plus domestic absorption of Indian Treasury sales and of home production	..	111	108	80	68	101
Net Imports of China	..	65	9	130	129	130
New Coinage in Occident	..	31	47	21	36	16
Industrial use	..	57	58	53	60	50
Total	..	264	292	284	293	297
Unaccounted for	..	8	13	-45	-22	-15

The following conclusions can be safely drawn from the above tables. Since the fall in the price of silver commenced in 1920 there has been greater absorption of it in the industrial arts. Were the price to rise rather to a great extent the result would be lessened industrial use.

Secondly, the new coinage demand in the Occident is falling. Although the use of silver is recommended in place of smaller cheques and credit instruments so as to bring about an economy of gold, for lesser gold would be needed for the lessened credit structure, still the Occidental countries have not translated this recommendation into actual practice. Since Great Britain reduced the mille-simal fineness of her silver tokens from 900 to 500 in 1920 and sold the released stocks of silver other Governments have followed suit. This unretained dumping of unwanted stocks of monetary silver has given a staggering blow to the value of silver. The Hilton Young Commission almost sealed its fate as a monetary metal and its plan of ultimate dethronement of silver meant immediate drop in its value. Most of the Eastern Governments have added fuel to the fire and thus there has been a steady deterioration in the value of silver as 63 mil. five ounces were being sold on average in the last three years by Great Britain, France and Indo-China.

The final death-blow to the monetary use of silver would have been imparted long ago had the Kemmerer Commission's recommendation to China to adopt a Gold standard in place of the present-day standard and the entrusting of its management to a newly created Central Bank been carried out in practice. Political chaos and uncertainty have prevented the scheme from being carried out *in toto*.* The temporary abandonment of the gold standard and the agitation to set up silver as a monetary metal once again to secure the much needed relief to gold have revived somewhat false hopes in the minds of the silver-producers. But we have already examined the main proposal of artificially fixing a high theoretical price of silver and its consequences. The next article will be devoted to the other quixotic proposals for the rehabilitation of silver.

*A State-owned Central Bank was created in China in 1928.

THE STABILISATION OF SILVER (PART II).

THE THREE FORMS OF REMONETISATION.

Attention was drawn in the previous article to the single remedy of outright purchase at the theoretical price of 30*d.* an ounce. We have discussed the dangers attendant on this measure. The stored-up silver cannot be released for industrial purposes at a high price. It can only be made use of for monetary purposes in one form or other. The plans framed for increasing the monetary use of silver will have to be examined in this article. Three variations of the remonetisation proposal can be discerned. These three measures, viz., Central Bank Note-cover, bimetallism and the revival of pre-war status, are planned out or meant to straighten out the real difficulties of the silver producers who will have to continue their over-production and still realise profit.

NOTE-COVER.

Of the three forms of remonetisation proposed the most important one is the declaring of silver as legal tender and compelling Central Banks of Issue to redeem a part of their obligations in silver as the Bank of France sometimes did in the previous century. This suggestion has emanated from the Federation of the British Industries and the Empire Economic Union.¹ It proposes that Central Banks should pay ten per cent. of their maturing obligations in silver and silver alone. To place silver as part cover of the bank notes is the gist of the above proposal. This suggestion is nothing but an attempt to revive an abandoned practice. The Bank of England was permitted by Section III of the 1844 Bank Charter Act to place silver up to one-fourth extent of its gold

¹ See the Newspaper Report of the Committee's recommendations on Empire Currency and Finance, the *Statesman*, p.10. Nov. 8, 1931. The same idea is repeated by Sir Hugo Cunliffe Owen, Chairman of the British American Tobacco Co., Ltd. See the *Englishman*, Dec. 14, 1931, p. 11.

holdings in the reserve. An extension of this practice is desired by the advocates of this proposal. The main object is to enable silver to carry the credit load along with gold as its sister companion. An organised purchase on the part of the Central Banks would have to be made to enable them to store silver in their portfolios and make payments in legal tender silver against the Bank notes and other liabilities. This would mean increased effective demand and would immediately help the Governments in their stabilising activities.

DIFFICULTIES OF THE SCHEME.

Although the immediate objective of raising the price of silver by means of concerted action would be forthcoming still there are certain difficulties attendant on this measure. If repayment in silver bars as is the case with gold bars in the gold bullion standard is the objective, it would bring about economy in the use of precious metals. A return to coin usage would be a retrograde step in the monetary field.¹ It would be forgetting the salient lesson taught to us during the war period. There should be uniform action in this respect on the part of all banks and a uniform percentage selected so as to disarm criticism. Granted that this is secured by international co-operation it does not solve the real monetary problem. The "money illusion" must be shattered as Prof. Fisher so ardently proclaims. Sound, stable and elastic money can never be realised under a single metallic standard, viz., be it gold or silver or bimetallism consisting of the joint use of gold and silver.

POSSIBLE RISE IN THE PRICE OF SILVER.

Nextly, if the organised purchase on the part of the Central Banks were to reinforce the arts demand for silver the inelastic supply would lead to the failure of the experiment.

¹ Of late all the Governments of the Eastern countries have been wisely rejecting all forms of metallic (silver) payments in their composite monetary standards. So the total coinage demand for silver has fallen from 42 to 28 mil oz during the last five years. See the Statesman, p. 8, 23rd October 1931.

The rise in the price of silver ensuing out of a scramble on the part of the Central Banks would lead to the breakdown of the experiment. The total note issue of the important Central Banks of the World amount to a high figure as shown in the following table.

Note circulation in 1930 of some important C. Banks and Governments. (000,000, omitted).

Country.	Bank.	Government.	Total.
South Africa (£)	8.5	....	8.5
Egypt (£.E.) .. ..	....	....	21.0
Canada (Dol.) .. ..	....	....	201.0
U.S.A. (Dol.)	2267	296	2563.0
Argentina (Peso) .. ..	....	1261	1261.0
Brazil (Milreis) .. ..	....	....	2771.0
Poland (Zloty) .. ..	....	....	1331.0
Roumania (Leu)	19605	....	19605.0
U.R.S.S. (Rouble) .. ..	....	....	4027.0
Yugoslavia (Dinar)	5397	....	5397.0
Australia (£)	42.5	....	42.5
New Zealand (£)	6.7	....	6.7
Japan (Yen) .. ..	....	....	1557.0
Germany (Mark)	5398	....	5398.0
Belgium (Franc) .. ..	....	....	16532.0
France (Franc)	76156	....	76156.0
Italy (Lira) .. ..	....	....	15680.0

In the above table^a the total note circulation of the Bank and the Governments has been placed before the reader. Sometimes the total figure alone is given. This is due to the unavailability of the detailed issues of the Bank and the Governments. The figures are stated in the currencies of the respective countries. The bracketed expression is the currency denomination of the country. In addition to these some of the Governments have been issuing coins also. But these figures are deliberately excluded by me as the metallic coins contain a cover within themselves which varies according to the value of the precious metal contained in them.

^a The figures in the table are taken from the Statistical Year Book of the League of Nations—1930-1931, pp. 220-222. As for the reciprocal parities of the different currencies, see Table I of the same publication, pp. 12 to 15.

If the Governments and the C. Banks were to so decide that payment of the note liability to the extent of ten per cent. were to be made in silver alone most of these which are storing gold assets alone will have to change their composition. Literally they will have to give up storing gold to the extent of silver reserve they mean holding according to this provision. The demand would be so great that the experiment would fail on account of the unavailability of silver to satisfy their huge requirements under this heading.¹

But it can be argued that the Central Banks and the Governments might be granted the privilege of paying gold or silver according to the Central Bank's convenience. Such a salutary safeguard can be enacted. A provision to this effect was engrafted in the charter of the Bank of France. Prior to the year 1928 when the Gold Bullion Standard was adopted the Bank of France could legally pay its obligations in Five-Franc Silver pieces if it desired to do so. A similar provision that these currency authorities can pay in silver or gold would make it a workable proposition. But considering the fact that silver supply might not expand to such an extent as to satisfy this newly arising demand this suggestion cannot be applauded as a safe solution.

THE SILVER CALF.

It would lead to setting up the silver calf along with the Golden calf on the monetary pedestal. So long as productive credit is tied up to such illusory metallic bases as gold and silver the credit machinery will not smoothly function. Such credit cannot expand to meet the producer's demand. But what guarantee is there that paper will not take the place of silver as it did in the case of gold? The weight of gold as well as silver will be prohibitive and go against their use. Silver certificates will be their representatives.

¹ The 1930 production was far lower than that of 1929 and it is stated that the 1931 production would be lower than that of 1930. See Mr. Kirk's article on Silver in the *Economic Journal*, Sept. 1931, p. 393.

NATURAL RELUCTANCE OF CENTRAL BANKS.

The present-day natural reluctance of the Central Banks to store silver has to be overcome.¹ In the past they have discarded silver as it became very cheap and plentiful. When the Bank of England made an attempt to increase its silver holding somewhat up to the limit permitted by the 1844 Bank Charter Act as part of the metallic reserve against the Bank notes this attempt was vigorously decried and since the "mother of all Central Banks" led the way the other Central Banks of the gold-using countries have been unwilling to treasure the fast cheapening metal, viz., silver. Such was the case of the historical failure.² Unless an intelligent and co-ordinated action through the Central Banks is brought about the value of silver might not rise to the theoretical price and get fixed at that level for comparatively long time.

PAYMENTS IN SILVER.

It has also been suggested that silver should be used to pay a portion of the Inter-Allied Indebtedness and Reparations Debt to America and to each other in turn. This sort

¹ Formerly most of the Central Banks of the Latin Union held vast quantities of silver in their portfolios when they were adherents of bimetallism. The following table gives one an idea of the quantities coined and the Bank holdings of silver.

<i>Quantities coined.</i>		<i>Bank holdings.</i>	
Fance (1866-1878) ..	£ 25,000,000	Bank of France ..	£ 49,480,000
Italy (1866-1879) ..	£ 14,360,000	Belgium National Bank..	£ 800,000
Belgium (1866-1876) ..	£ 14,000,000	Bank of Italy ..	£ 2,120,000
Switzerland (1866-1876) ..	£ 320,000	Swiss Bank ..	£ 480,000
Greece (1866-1876) ..	£ 600,000		
	£ 54,280,000		£ 52,880,000

See B. A. White—Silver, Its History and Romance, p. 284.

² Quite recently Germany determined to steady the Gold standard by restoring silver as monetary metal. She is buying silver for minting the same and about 120,000,000 marks are minted for internal circulation. See Reuter's Telegram from Berlin—Oct. 31, 1931—quoted from the *Statesman*.

of payment has to be validated in course of time by the receiving countries. The famous Pittman Act of 1918 (U. S. A.) contains a similar provision as the above one. With the aim of conserving the gold stocks of the country it permitted the settlement in silver of trade balance adverse to the U. S. A. The paying or the borrowing countries can easily hope to pass such a resolution but it is the receiving or the lending country that has to accept it. So long as Silver's value is cheap and unsteady there can be no such international acceptance which this suggestion anticipates.

After all if the U. S. A. were to be saddled with so much of silver it will not solve the monetary problem. Such a provision might temporarily enhance the value of silver but permanent stabilisation at an artificially fixed high price cannot be maintained without undergoing some economic sacrifice. Is this sacrifice worth while for simply storing silver as metallic bullion which after all is not real wealth?

BIMETALLISM.

The second variation of the scheme is to make the important nations adopt bimetalism and make it international in scope if possible. Academically speaking, this form of the proposal is free from theoretical criticism provided it is all-pervading or universal in its scope. Were all countries to adopt a fixed ratio between silver and gold*, the varying rates of production of the metals would not succeed in varying the price of the metals. The combine of the different mints of the countries can regulate the value of the precious metals. The present-day fluctuations in the separate value of gold and silver are far greater than are desirable. This would not be the case under bimetalism. The value of gold and silver together in the joint standard would be steady. But if the production of both the metals were to be greater than the monetary needs

* Senator Borah proposes the ratio of 14:1 between silver and gold. See *Statist*, Oct. 24, 1931.

and the industrial demand of the nations the experiment would prove a failure. Gold monometallism was selected by almost all European countries as they found that both gold and silver were being produced very fast and to avoid inflation of currency they discarded silver, the less precious metal. But as every keen student of monetary economics knows, bimetalism has the unfortunate defect of degenerating in course of time to an alternating standard according to the undervaluing or overvaluing of one of the metals brought about by varying rates of production. That the undervalued metal disappears from circulation and an alternating standard would be the new monetary regime is too well-known to the advocates of bimetalism. The most ardent advocate of international bimetalism does not claim for his scheme any greater virtue than that of imparting greater stability to the value of the precious metals than is the case at present. The greater the expanse of territory belonging to the International Bimetallic Union the longer would be the scheme in operation. But as Dr. Shaw points out clearly, "any and every system that the art of man can devise which attempts to link the two metals together will break down".

CONDITIONS OF SUCCESS.

One thing which the advocates of international bimetalism have to bear in mind is that the arbitrarily selected ratio between gold and silver would have to be particularly conducive towards a rise in commodity prices. If the Mint price of one ounce of silver is fixed arbitrarily in such a way as to raise the present-day gold price of silver¹ and if the monetary circulation were to be augmented the commodity prices would rise. Nothing is more important than this. Were the gold

¹ Mr. H. E. Moon in his recent pamphlet on silver and bimetalism makes allowance for this suggestion. Without bringing about an all-round temporary stimulus by slowly raising commodity prices this monetary reform will not cure this present-day world trade depression. But so long as tariffs hinder the free flow of goods a mere monetary remedy cannot cure the present-day position.

price of silver to rise the silver interests would be pleased. Decreasing gold can be augmented by its old help-mate—Silver. Lasting ties of friendship can again be forged between the two metals. Falling commodity prices under a regime of decreasing gold stock is the world's monetary bugbear. This can be remedied. Silver would rise in the estimation of the public and this would satisfy the silver interests for the time being. It would mean, as in the previous case, a criminal waste of the tax-payer's money on the part of the different Governments. It would lead to a world-wide waste of energy.

DOES NOT SOLVE THE MAIN MONETARY PROBLEM OF
CHANGING VALUES ?

A vigorous controversy on bimetallism would again be launched upon by the currency enthusiasts. But the real issue in currency matters is to attain comparative stability of prices. Whether the currency standard should be tied to this metal or that is not the criterion. Any real monetary advance cannot be secured by resort to international bimetallism or by managing the gold standard in such a way as to yield complete satisfaction to all. Even the improved gold standard cannot give tolerable stability to the price-level. There can be no adequate and rational solution to the question of our stable standard which would have to reward equally all human efforts and secure equal justice to all classes of society if silver were to be merely substituted in place of gold. Popular allegiance was unfortunately wrongly shifted from the silver metal to the gold standard which was adopted by Great Britain in 1816. During the years 1873 to 1893 silver proved to be a more stable standard than gold.¹ But the fascination

¹ See E. W. Kemmerer "Modern Currency Reforms", p. 21. He proves conclusively that the silver standard of Shanghai was more stable than that of the gold standard of England. It was the value of gold that was appreciating and caused the instability. But as Sir Charles Addis says, "the superior convenience and economy of gold has enabled it to oust silver as a medium of international exchange." See his introduction to Benjamin White's "The History and Romance of Silver" p. viii.

of the yellow metal or the compelling necessity of having a common standard with Great Britain and her vast Empire countries forced Germany and other countries to abandon silver and adopt gold monometallism. But silver has lost its fascinating hold nowadays except on the Eastern masses. It is no longer a metal of international acceptance.

RESTORATION TO PRE-WAR STATUS.

The third variation of the remonetisation scheme is as follows. It proposes to restore silver to the pre-war status, viz., the attempt is to make Governments agree to use silver for subsidiary coinage of the old fineness.¹ Secondly, they should not sell their unwanted stocks of silver in the glutted market without informing the Silver-selling Syndicate of their action. This Syndicate or Corporation would have to inform the respective Governments of the actual state of production and the market conditions of silver. Thirdly, there need not be any interchangeability between gold and silver. They will circulate in complete independence of each other. This modest proposal is formulated by Mr. Brownall, Chairman of the American Smelting and Refining Company of New York.

COMPARISON WITH OTHER SCHEMES.

Of all the above schemes this is the least harmful. It has the merit not only of not sacrificing the silver interests but pays proper heed to the position of gold. It aims at setting a *parallel standard* and not a *double standard* as in the case of of bimetallism. In the earlier forms of the remonetisation schemes the consequences befalling on gold have not been borne

¹ As the price of silver began to increase an increased use was made of nickel, bronze, and paper as subsidiary money. These Governments now seem to have fallen too much in love with these substitutes to wish for the reinstating of silver coins which would be costly. Since Oct. 1931, the price of silver is on the ascendancy and if the theoretical price were to be the ruling price this substitution can never be thought of.

in mind. The value of gold would fall as soon as monetary demand would not press hard on the dwindling gold stocks. It might be that it might afford a suitable and welcome relief just at present as gold stocks tend to dwindle according to the monetary prophets. From the standpoint of modern finance the use of silver coins also has to be discarded for the corresponding wear and tear of silver coins also would amount to a culpable waste and criminal folly.

ITS EFFECTS ON GOVERNMENTS.

This scheme would stimulate effective demand for silver and would regulate the supply of silver to be disposed off in the world markets. But the Governments of the silver-using countries would consider this step as an "organised loot" and mere "legalised plunder". Having once discarded silver even for subsidiary coinage purposes they would be forced to retrace their steps and begin the recoinage of silver token coins. As this step does not enable them to reach the monetary goal they will hardly have real and abiding sympathy for this modified scheme. A Sir Robert Horne might plaintively raise the cry that as "Governments have muddled it is Governments that must provide the remedy". As a member of the joint standard silver would have to be welcomed by these Governments. Gold and silver would be circulating without having any interconnection, fixed ratio for interconvertibility or any other form of reciprocal relationship.

CAN THE PROMISED GOAL BE REALISED ?

Granted that the least harmful variation of the remonetisation scheme is adopted does it mean that all the much-talked-of advantages would be immediately realised ? The first and the most patent disappointment would occur in the field of the enhanced purchasing power of the Eastern masses. Even granted that silver lies dormant in small hoards here and there in India, China and the Eastern countries it does not

immediately follow that their purchasing power would be enhanced. These jewellery hoards will have to be melted and sold as bullion before enhanced purchasing power can be possessed by them. Even supposing that this would take place it does not immediately follow that these Eastern masses will purchase the European manufactured products alone. Plain living and high thinking characterise the ambitions of the Eastern people. The tawdry products of the modern industrial organisation of the Western countries make no immediate appeal to them. They do not want more wants. It would not be far wrong to consider them as the direct antithesis of the "economic man".

CONCLUSION.

Any hasty action is detrimental to several interests. Unless the International World Conference on Silver¹ which the Washington Government is about to organise or the League of Nations were to outline a consistent course of action with reference to silver a policy of masterly inactivity has to be pursued by the silver-using countries. The artificial fixation of the price of silver would be an economic error or a Himalayan blunder. General social welfare cannot be promoted by hasty and panicky legislation in this direction. It does not bring us any nearer the monetary goal. Changing price-levels are the curse of the present-day economic organisation of the most advanced countries. It is for society to "sense" these evils and try to rectify the same. No metallic standard can hope to combine effectively the dual rôle of acting as the medium of exchange and a reliable store of value at the same time. Why then revive silver as a monetary metal?

¹ The Right Hon'ble Neville Chamberlain has rightly discarded this proposal and without the Government of the United Kingdom being represented any proposal to hold an international discussion would be futile.

As for the future of silver, the only sensible suggestion is to increase the different uses to which it can be put. Scientific research must play an important part in any wisely conceived plan for the rehabilitation of silver.

To reiterate all that the Eastern Governments may do is to mint more subsidiary silver coins and perhaps also raise the amount for which they can be declared legal tender. This is the utmost help that can be safely granted to the silver interests if at all they deserve any mercy. But they must not agree to pay a high price as suggested by Hon'ble (now Mr.) L. S. Amery or some of the American silver producers. Nothing further can be done to protect the silver interests and it is an idle dream to expect that silver will at any time emerge from the days of its present humiliation.

APPENDIX II.

INDIA—THE GOLD STANDARD—THE PRESENT CRISIS¹

The dominant concern at the present time is the subject of the gold standard. Mr. Philip Snowden has announced his intention of summoning an International Conference to discuss the possibility of bringing an equitable distribution of gold and thus internationalise the gold standard.

But what is the modern gold standard whose meaning, scope, limitation and interpretation are radically different from that of the pre-war gold standard and whose suspension has created so much stir? A country is said to be on the modern gold standard when the domestic currency or monetary units are made convertible into a definite fixed weight of gold. There is either *de facto* or *de jure* linking to gold. The value of all commodities and services are measured in gold and all deferred payments are made payable in legal tender money which itself is convertible into gold bullion bars. Gold is used as the backing for internal currency and used for adjusting international obligations arising out of a multitude of individual payments, exchange of securities and services on the part of the people of one nation to another. If gold has won an accepted position as a regulator and governor of commercial and financial values in any country it can be stated that that country is on the gold standard.

In England the relationship between gold and the other money units is fixed arbitrarily and artificially by the Bank Act which says that the Bank of England must sell gold on

¹ This paper was read before a meeting of the Bengal Economic Society on 5th Oct., 1931. Mr. D. P. Khaitan—Member of the Central Banking Enquiry Committee, presided and extolled the highly scientific character and the accuracy of trained processes of economic reasoning indicated in the discussion of the subject.

offer of other forms of legal tender money at the rate of 400 ounces at £ 3-17s.-10 and $\frac{1}{4}$ d. an ounce. An abrogation of this sale of gold means the suspension of the gold standard by the country. This is the most liberal interpretation of the meaning of the suspension of the gold standard one can give. Norway, Sweden and Denmark are off the gold standard already. It would not be a surprise if the other debtor countries of the world finding it impossible to part with their dwindling stocks of gold determine to be off the gold standard. These countries might try to refuse to tie "their currency and price-level ships to the common buoy—gold." Unstable currencies with bewildering rates of exchanges will be the prevailing monetary phenomenon.

The following table shows the gold holdings of the Central Banks of some of the important countries. If some of these do depart from the gold standard as a result of the departure of gold from the banking system there would be no surprise.

GOLD IN MILLIONS OF DOLLARS.¹

Country.	Held at the end of 1930.	Increase 1925-1930.	Decrease 1925-1930.
U. S. A.	4,225	240	—
France	2,099	1,388	—
United Kingdom	722	18	—
Germany	544	241	—
Spain	471	—	19
Japan	412	—	164
Argentina	411	—	25
Italy	279	58	—
Russia	249	155	—
Canada	194	—	32
Belgium	191	138	—
Netherlands	171	—	7
Switzerland	138	48	—
India	126	17	—
Total	10,232	2,303	247

¹ This table is taken from the Statistics of Gold Movements in the selected Documents on the Distribution of Gold submitted to the Gold Delegation of the Financial Committee of the League of Nations, pp. 65-67.

The small holdings are not taken into account in the above table. Australia, Brazil, Chile, the Dutch East Indies and Denmark have lost gold to a certain extent, while Poland, Austria, Hungary and Czechoslovakia have increased their gold holdings.

THE GOLD STANDARD IN INDIA.

Even according to the previous understanding of the gold standard system the present-day Indian currency system cannot be said to be a gold standard one. Some of the Indian economists refuse to consider the Indian currency standard as a gold standard one.¹ The value of goods and services in the country is measured in terms of the rupee. But the psychological abstraction of the "gold rupee" which the gold bullion standard requires is not realised by anybody. The postponing of the standard and the Reserve Bank Bill of 1928 meant that a kind of exchange standard is being maintained. But in the remote sense that the rupee was converted into pound sterling currency which was equivalent to gold we can indirectly claim to be on the gold standard basis.² However, there is a world of difference between the giving of gold, bars and sterling. No sooner was sterling given for domestic currency the rate of exchange became the arbiter of the volume of currency. Instead of changes in the internal purchasing power of money from its parity with gold being considered as the proper data for ascertaining the deficiency or superabundance of money, the rate of exchange has become the all-important factor. Thus India has been on the gold exchange standard basis.

MISGUIDED ENTHUSIASM.

There are several people who entertain highly elated notions concerning the desirability of suspending the gold standard at this juncture. Whether gold is to be had or not

¹ See Prof. K. T. Shah, Evidence, Hilton Young Commission, Qn. 8870.

² The Macmillan Committee says, "For an effective working of the gold standard it is sufficient if the local currency is exchangeable for another currency which is itself convertible into gold", p. 19.

the mere suspension would grant a temporary fillip to trade which would have to be greatly welcomed in the days of world depression. But the export bounty arising out of depreciated currency cannot be reaped if a large number of countries are off the gold standard. Traders and businessmen who feel the pinch of ready capital which cannot be obtained at low rates of interest denounce the rigid gold standard as a "fraudulent standard". But without convertibility into gold the currency standard can be vigorously abused to secure certain temporary measures. Hence the twin methods by which the efficiency of any monetary system is secured are the well-known principles of convertibility and limitation. The first might be a mere facilitating principle but without the observance of the second there can be no successful regulation of the currency standard. Without proper observance of the limitation principle the test of convertibility cannot be secured for any considerable length of time. Both can exist together and flourish like the proverbial Siamese twins. The existence of both these safeguards will make the standard "knave-proof or fool-proof". I strongly demur to the false notions of elation and illusory prosperity which are supposed to be the attendant advantages on a country pursuing the path of the suspension of the gold standard. Mere suspension by itself is not attendant with grave risks. But it means you have set foot on the inclined plane and there will likely be a rapid downward slide. Mr. McKenna correctly observes that "the fear of being forced off the gold standard acts as a salutary check on the extravagance of Governments who might be willing to face a mere fluctuation in exchange but would not dare to suspend the specie payments".

INDIA OFF THE GOLD STANDARD.

The Ratio Act of 1927 has familiarised the people with the conception of the "gold rupee". The rupee was linked to 8.4751 grains of gold. Domestic silver rupees and paper currency are to be converted in certain minimum quantities into gold bullion bars of 1065 tolas at Rs. 21 11s. 9 p. per tola

each. These gold bullion bars, which ought to have been available to the people *whenever and for whatever* purposes they demanded it, have not been made available even for exportation purposes. But to discharge this obligation sterling, which was equivalent to gold, was allowed to be given at 1s.5d. and 49/64d. It was *not actual practical conversion* into gold bullion bars but *mere theoretical authorisation* that existed in the Indian Gold Bullion standard system. This regulated gold-less silver rupee standard commonly designated as the gold bullion standard has broken down at the present time. Due to the lack of gold bullion bars the provision for the sale of these proved to be a mere eye-wash and the *de jure* gold bullion standard worked out in the practical field proved to be a mere *de facto* gold exchange standard. The convertible rupee was converted into sterling or gold exchange. The suspension of the gold standard in England completely altered the position for the sterling has become an inconvertible paper currency whose internal value at least ought to depend on mere output. If budgetary or fiscal causes were to inflate the paper pound sterling it would become depreciated in value. Instead of considering the present moment as a grave emergency and suspending the sale of gold or sterling according to the Act of 1927 the rupee has been linked to sterling at 1s.-6d. ratio, even without the consultation of Indian public opinion.¹ The Finance Member is no longer calm and at ease. Like the sea captain who, finding his ship moored to a buoy that has been anchored to nothing, feels ill at ease so also our Indian Finance Member finds his currency ship anchored to the sterling buoy which finds itself drifting wherever the currents of political uncertainty or financial instability might tend to take it.²

¹ The pros and cons of linking the rupee to sterling or gold or leaving it to find its normal level are carefully elaborated in Appendix I.

² See the Report of the Babington Smith Committee, Para. 34.

PRACTICAL CONSEQUENCES.

The first Ordinance suspending the sale of reverse drafts according to the terms of the 1927 Act was wisely conceived and boldly promulgated. The Bank of France had on several occasions to suspend cash payments. The British Government often suspended the Bank Charter Act. Such suspensions can be easily justified on the ground of national emergency. The failure to operate an inconvenient ratio meant after all exchange instability. Exchange would have been forced to find its own level. The independent rupee not convertible into sterling or gold would have depended for its internal value on careful regulation. Its immediate external value might have been depending on the confidence reposed in its stability by foreign businessmen and traders. Though a temporary setback might result due to lack of confidence she would have quickly recovered from the shock. The external value of the rupee would have been proved by its own virtue. There would perhaps be no surprise if it were to fall to a level worth its weight in silver. This would certainly take place under a regime of inflation. But the evils of fluctuating exchange have been magnified though authoritative Committees¹ have reiterated the opinion that, exchange stability is a matter of convenience and "important facility and not an essential condition". Indian trade flourished during times of unstable exchanges. The experiences of 1870-1890 need not be recounted. Even during the days of rising exchange, as in the years 1921-1925, trade did flourish.

At the behest of the Secretary of State for India the rupee has been linked to sterling which has depreciated in terms of gold. This enforced departure from the *de jure* gold bullion standard or the hardened *de facto* gold exchange standard has destroyed public faith in the rupee or the monetary unit.

¹ I am indebted to Sir H. Strakosch for this metaphor.

This alteration of the monetary standard is nothing but a serious moral offence and a violently grave breach of national faith as the gold standard countries would put it. This arbitrary fiat can be justified on the plea of grave economic necessity. But the end has to justify the means. If external trade and internal business operations which have almost come to a stand-still on account of the high internal value of the gold rupee were to be rejuvenated by this alteration of the legal standard there would be some justification. But it is too early to say how real good can be conferred on India by this measure. Will it be anything more than a temporary solution if the rupee is linked to sterling and the more fundamental cause for bringing about relative stabilisation of international prices is neglected ?

ECONOMIC IMPLICATIONS.

The implications of this sudden departure from the administrative practice of the Government have to be fully realised. Firstly, it means that the Secretary of State is all influential in initiating any monetary policy and carrying it out even without consulting the wishes of the Government of India or Indian Legislative Assembly. A matter-of-fact economist of my stamp cannot hope to comment on this situation except by repeating the conviction that the present-day regime of divided financial control between Whitehall and Simla has to be remedied at the earliest possible opportunity.

Secondly, it has made the currency authority control all exchange operations so that the contractual obligations of genuine traders and the real domestic requirements might be fulfilled on 1s. 6d. sterling basis. Illegitimate and speculative requirements would be curbed to a certain extent and in so far as the Ordinance can be avoided there would tend to be a drain of gold resources of the Government. Exchange control was once experimented with in 1920. Reverse Councils were sold in limited quantities to the specially selected banks. The needs of the

genuine small remitter were not only overlooked but as soon as it was known that rationing was to be practised the applicants always exaggerated their real requirements so that their actual allotment done on a *pro rata* basis might come up to their real requirements. That was how deception was practised. It is part of human nature to resort to subterfuges, good, bad or indifferent, when individual liberty is cut down.

Thirdly, the Imperial Bank of India has been placed in a position to control the exchange operations. It would thereby enable it to learn the technique of the exchange operations and make it fit to transact exchange operations on a wide scale as soon as it is deprived of the semi-Central banking operations it is conducting to-day. It has become an open secret now that it is casting covetous eyes on the field of foreign exchange and the present-day experience would enable it to easily tack on general foreign exchange business as soon as the C. R. Bank is started.

Fourthly, the absence of a stable domestic exchange banking machinery is deplorable. The Bank of England was never controlling the exchange operations even in times of this dire economic emergency. The heads of the foreign exchange departments of the Big Five are performing this duty and beyond the appeal to patriotism of the British public not to depreciate the pound sterling no interference with the day-to-day administration of the exchange banking machinery has been brought about.

Fifthly, the necessity of publishing with utmost possible expedition the figures of the sale of sterling and the details of the adequate machinery which has enabled the Indian Government to secure the support of His Majesty's Government for securing sterling resources has to be realised. There is indeed one danger which the publicity of this arrangement might bring about. The depletion of the sterling credit resources will

¹ See Mr. Macdonald's Evidence referred to in Mr. Manu Subedar's Minority Report—C.B. Enquiry Committee Report, p. 284.

accentuate the difficulties but as psychological or speculative factors are removed by exchange control it will provide a natural limit to their influence.

Sixthly, the additional bounty which depreciated sterling would confer on British exports would be of little avail so far as the Indian market is concerned. The manner in which it has been secured has alienated the sympathies of all well-meaning citizens. The continuance of strained feelings arising out of domestic political situation would be a grave handicap. The fixed wage-earning class and the salaried people who generally consume the British manufactured goods are already feeling the pinch as a result of the depreciation of the internal value of the rupee. They would fain be able to increase their demand for either the imported British goods or those of other gold standard countries. The future budgetary position of the Government of India would become rather grave in spite of present-day balancing measures. This would entail further taxation which would restrict the ability of the Indian consumers to purchase foreign goods.

Seventhly, the additional bounty which depreciated rupee gives to the Indian exporters in the matter of transactions with gold standard countries has been grossly exaggerated. Because 76 per cent. of our trade is with gold standard countries this temporary stimulus would be secured. India exports mostly the raw materials of commerce and agricultural staples. These have been unfortunately overproduced in most countries of the world. Indian wheat can find no world market. Rice can find no Eastern markets till an export credits scheme or some other device will enable China and the Eastern markets to demand it. Indian cotton will find it difficult to secure a market in face of the huge output of the U. S. A. cotton, part of which was bartered for so much coffee of Brazil. So an immediate improvement of export trade except in the case of those goods where India has a *quasi-monopolistic* control

cannot be expected. Taking jute which can be reckoned under this category, the demand for it would be slack till the present overstocking of the foreign markets disappears. An all-round stimulus to external trade can hardly be expected when the foreign consumers lack the effective demand for our goods. Internal commodity prices have risen already as a result of the depreciation of the rupee but permanent easier export trade conditions cannot ensue out of this step. A depreciated rupee means "the real value of salaries, wages, interest payments and debts will all be reduced". It is not national but class prosperity that is ensuing out of this step. There can be no real national wealth arising out of it.

Nextly, the artificial support of the sterling rupee at the high level of 18*d.* is to give scope to transfer of the sterling investments made in the country without any possible loss which might arise were sterling to fall to a lower figure. It is the holders of sterling that ought to have borne the exchange loss. Equity demands that the rich investor should bear all risks attendant on the transfer of repaid capital and interest but it is being thrust on the poorly equipped borrowers. India's financial independence would mean no longer preferential conditions to external investors. But mere safety is not however endangered thereby.

Ninthly, the flight of gold and capital from the country would take place to countries where political, social and credit conditions are more secure and free from attendant risks of currency depreciation and political uncertainty. A continued retrogression of the rupee would mean a further stimulus for the flight of capital. The export of gold is taking place mainly in order to take advantage of the insistent demand in European and English markets. So long as the price of gold is below dollar parity this movement will continue. An embargo on gold and the acquisition of gold at the import point of sterling-rupee exchange, *viz.*, 1*s.*-6½*d.* by the expanding of currency would kill two birds at one shot. The gold resources would

expand and internal prices would have the needed fillip. But the maintenance of high exchange value for the rupee would become impossible under such conditions.

Again the British Government's financial support to enable it to discharge the India Government's ratio obligations stand unrescinded. But in view of its own inability to secure substantial credits from abroad the promise of a weak borrower is rarely a convincing and reassuring one. But these long-term credits could at the same time be arranged by a financial mission sent to New York and the linking of the rupee to gold at the present-day ratio of 1s. 6d. gold, would mean the continuance of the *status quo*. The possibility of paying sterling obligations indirectly through the dollar credits would add to the embarrassment of the sterling situation. Further depreciation of sterling would ensue as a result of India's efforts to pay sterling indebtedness through the gold markets.

Again, this episode of linking the rupee to the sterling clearly shows that the stability of the rupee sterling exchange is the only dominant consideration of the Government of India. It does not appear as a custodian of the general public interests when it undertakes to supply the machinery which would enable the merchants or remitters to cover their risks. The Exchange Banks are the instruments whose intimate touch with trade will enable them to shoulder this risk.

The next point of criticism against the new Ordinance is the promise to give gold also or sterling provided the amount demanded is through the scheduled bank for the minimum amount and satisfies the regulatory authority that it is a *bona fide* demand for exportation purposes in lieu of discharge of past contractual obligations or for definite domestic purpose requirements of the remitters. It is one-sided stability that is now being enforced as a result of the Ordinance. It is the reverse draft at 1s. 5 $\frac{1}{2}$ d. that is available. Domestic currency is not being released even at 1s. 6 and 3/16d. sterling

ratio. The refusal to take gold and release currency at this import point means that the par points are not fully operative.¹

CAN WE INTERNATIONALISE THE GOLD STANDARD ?

If the energy of Great Britain were to fructify in the formation of an all-World Conference for stabilising the position of gold and bring about a satisfactory adjustment of gold holdings good cometh out of evil. It must be a public international conference at which the respective claims of Central Banks to increase the gold reserve would be examined by a body of experts. But we must not commit the mistake of going to the unrestricted gold standard suddenly or too soon nor enforce an overvalued rupee and an onerous exchange ratio. Unless and until the world economic crisis were to be effectively tackled there would be no possibility in attaining stable trade and exchange conditions. Resort to the post-war gold standard would only mean the prospects of early suspension. Without internal monetary use of gold a scientific gold standard involving intelligent management can be made to work.

WHAT OF THE IMMEDIATE FUTURE ?

If the above findings clearly indicate that a restoration of the international gold standard can take place in the remote future alone what has India to do in the meantime ? Till the expiry of the Ordinance period the rupee stands linked to the sterling. But at the end of this period the rupee should be declared an independent currency neither linked to sterling nor the gold whose future is on the laps of gods alone. Before discussing the ratio at which it ought to be linked if the international gold standard were to be adopted the consequences of the adoption of an independent rupee standard have to be understood. An independent rupee carefully regulated would

¹ Since these lines were written the Government have been purchasing sterling at 1s. 6 and 3/16d. Hence a *de facto* stability of the rupee is to be had at present.

not cause any embarrassment to the gold reserves of the country. The Finance Member's argument that "if the Rupee was not linked to sterling the difficulties of India Government to raise money abroad would be almost insuperable" needs refutation. He is repeating afresh the old argument of the British capitalists who wanted steady sterling-rupee exchange in the days of the past nineties. The ability to raise credits abroad depends upon the financial ability of the Government. A financially unstable Government like Australia's was refused a loan either in America or England though it was on the gold standard. If the Government of India were to follow the proverbial rake's progress it is not external credits alone that would be denied but even the more thoughtful of the domestic creditors would think twice in granting the needed resources. Granted that America does not play fairly the game of a creditor an appeal to the newly started Bank of International Settlements¹ will have to be made through the C. R. Bank.

Under an independent rupee standard India will not find it difficult to raise the necessary sterling resources to pay the annual 32 mil. liability and pay off any other maturing sterling loan obligations of the Government. It is almost a truism to assert that a country should have command over other countries' currencies with which it trades. Although India has trading relations with most of the important countries of the world she needs command over four major currencies in order to discharge her obligations. Sterling, the dollar, the guilder and the yen are the important currencies needed by this country. The sterling requirements of India predominate over other currency requirements. It is the realisation of this fact that makes the people say that sterling requirements ought to be secured at a fixed and stable ratio in terms of the rupee. A stable sterling value of the rupee does not mean that sterling values of other countries' currencies can be stabilised. The

¹ See Dr. O. W. Sprague's paper, "The Working of the Gold Standard".

trade with gold standard countries would be disturbed on account of the fluctuating value of the sterling in these currencies.

UNSTABLE STERLING.

Granted that linking with sterling in normal times when sterling is equivalent to gold is an advantage, it does not follow that the rupee ought to be linked to inconvertible sterling. Even a rat deserts a sinking ship almost instinctively. If it were mere disassociation with gold that is the main weakness of sterling there is nothing inherently defective in such a position. But there is no definite assurance that the sterling will not follow the path of the franc of 1921-1928 or that of the mark of 1921-1925. Were the Labour Government to be returned to power and were they to persist in the policy of adding outlays of unproductive character in spite of deficit budgets and threaten to carry out class legislation, there would be no knowing where the pound sterling would be standing. Its future is uncertain as there is impairment of confidence as a result of the absence of economy in Britain's national expenditure.¹ An inconvertible currency like the paper pound sterling can be easily subjected to the influence of the petty, national politicians. It is an elementary economic truth which says that an inflated currency would be entirely valueless and afraid of further taxation measures the political party in power might bring about perpetual interference with domestic currency values. Unless and until this assurance is also given that no inflationary influence will be exerted on paper currency the Government of India ought not to have agreed to link the rupee with the fluctuating sterling.

¹ See Sir George May Committee Report. This famous Economy Report explains the National Crisis in England. It points out the urgent necessity of balancing the budget and making it of smaller dimension than before. The central wealth fund of the Nation must increase before national solvency will become an accomplished fact.

INDIA NOT A MERE DEBTOR COUNTRY BUT A DEBTOR-CREDITOR COUNTRY.

Too much capital is being made by the advocates of exchange stabilisation policy of the fact that India is a debtor country. Correctly speaking, India at present is on the debtor-creditor basis. The Memorandum on the Balances of Payments points out that no net claims are being built by India on the other countries of the world. If it were a real creditor country the net claims it builds on other countries would be increasing. When as a whole we find ourselves in a transition stage as it were, this insistence that sterling and sterling alone will help us is meaningless.

We can maintain an economical and efficient internal currency which is at the same time suited to the requirements of the people. Its external value would depend not only on its internal value but in times of international instability in foreign currencies the changing value of foreign currencies would have its own repercussion on the value of the domestic currency. The domestic banking system should be able to understand the influences and facilitate the matter of transition from the debtor to the creditor status.

THE IMMEDIATE ISSUE.

India's main trouble as in the case of most other countries lies in the greater fall of agricultural prices than that of the manufactured commodities used by it. This problem can be attacked in two ways. Either the prices of manufactured commodities can be pushed down or the prices of agricultural staples have to be raised. As periods of slowly rising prices secure economic relief to almost all sections of society it is this ideal that is being advocated as a desirable remedy in all countries. A modest watering and not an inflationary issue of currency would be required to bring about such a rise in commodity prices.

The recent very considerable developments of the heavy general tariff that are being brought about would not fail to produce a rise in the normal rate of exchange. The currency authorities should pay heed to these changes in the tariff while fixing the rate of exchange in the near future.

It is an immediate rise in prices that is needed rather than the securing of the ideal exchange rate of pre-war times without *any* rise in prices. A modest rise in prices and a stabilisation of the internal level of prices at that point is the crying need of the hour. While allowing exchanges to go hang, the attention of the Government can be concentrated on the stability of the internal prices so long as international prices tend to be unstable. This policy ought to be our aim as soon as the present Ordinance expires. It is the level of prices that matters and not exchange rates. Linked neither to gold nor sterling the rupee can be made to possess a stable internal value as it did during 1919-1921 period so that the entire business interests of the country stand to gain out of this step. This policy of internal price stability would help us in the contingency of the sterling becoming stable for it will secure a stable ratio for the rupee in terms of sterling.

IS AMERICA REDISTRIBUTING GOLD ?

The period of redistribution of American gold stock which was impeded by the Stock market boom of 1927-29 seems to have commenced afresh. American gold is being shipped to France, Switzerland and Holland. The shortage of gold in other countries can be directly attacked and the economic allegiance of these countries to the gold bullion standard can be secured thereby. India should be represented at the World Economic Conference which would discuss the future of the international gold bullion standard. On the solemn and distinct promise of not using the gold stock for gold currency we should secure American or French gold and help the broadening of the international gold bullion standard. But nothing

would be more important than to suppress the inborn predilections of the people for imports of precious metals and for unproductive hoarding in the jewellery form.

If America and France were to refuse to part with their gold stocks the idea of the Bank of International Settlements managing the gold reserves of the world in such a way as to maintain reasonable stability in the international price-level may and should be exploited.

But if this suggestion is not feasible there would be the triumph of the anti-metallist ideal, *i.e.*, managed currency with the special object of maximising stability of prices and exchanges at a minimum social cost. By pursuing the domestic policy of internal price stabilisation during these days India can blaze the trail of general monetary policy and reconstruction.

A POSSIBLE CONTINGENCY.

As soon as sterling rises to its gold parity, for every one in England who has studied the Macmillan Report is convinced of the futility of devaluating sterling as a remedy to the present crisis, attempts will be made to stabilise the rupee in terms of sterling which has reached parity with gold. The present-day sterling exchange standard ushered in by the Ordinance would give way for the *de jure* gold bullion standard which however would be worked in the manner in which a *de facto* gold exchange standard would be working. The legal fiction of gold standard would again be spun but in administrative practice it would tend to degenerate to that of a gold exchange standard. Unless and until it is a form of the improved gold exchange standard almost coming up to the "ideal gold exchange standard" of the economist's conception, the Indian public should emphatically protest against its adoption. It should be the duty of the Currency League to educate the public by issuing small leaflets on the different standards—their merits and demerits and their suitability to this country. The working of the improved gold exchange standard would bring about the

expanding of the currency of the gold exchange receiving country and tend to contract the currency of the other country.¹ But as the Hilton Young Commission has wisely stated, the Indian public cannot find the gold exchange standard mechanism easy to understand and simple to operate.² It does not secure the internal convertibility of the token currency into metallic gold. Any future currency system for this country must give this right and must be worked on this definite understanding. The real gold bullion standard gives this right and, as Dr. L. J. A. Trip admits, the gold bullion standard system has met no criticism.³

HOW CAN INDIA ACHIEVE THE REAL GOLD BULLION STANDARD SYSTEM ?

This can be done by starting the Central Reserve Bank. This C. R. Bank should be provided with the necessary foreign exchange assets in sterling, dollars, guilders and yen and a gold reserve to cover its notes and sight liabilities. With the return of more settled conditions in the international money markets than are existing at present the exchange should be stabilised at round about the normal level at which it stands at the inauguration of the C. R. Bank and the collection of the proceeds of the external loan. As a low exchange would have an adverse effect on our external debt the monetary experts should be careful in fixing the exchange value of the rupee. But it ought to be done on the basis of rate discovered to be normal as a result of allowing it to move freely up and down for some considerable length of time.

A NEW MONETARY PHASE.

The Indian monetary system would then be entering another phase of its career. Confidence in the future of India

¹ See the paper entitled "The Reform of the Gold Exchange Standard." Select Documents of the Gold Delegation Committee of the L. of N.

² See Hilton-Young Commission Report, pp. 24-32.

³ See Dr. L. J. A. Trip, Paper entitled "The functioning of the Gold Standard."

would largely depend on the belief both in India and outside in the stability and efficiency of the monetary system. Many people are not aware that the Indian Government cannot arrange any external loan without the sanction of the British Parliament. Genuine efforts should be made to induce the British Parliament to grant us this power. With an assured budgetary equilibrium and an unproductive debt which is very small there is no reason why American financiers would fight shy of financing us. If the loan proceeds were not to be locked up in barren gold currency units there can be no economic reason for the refusal.

Attempts should be made to garner more gold resources for an efficient working of the gold bullion standard by the C. R. Banking machinery which needs at least 80 to 100 ma. worth of gold.

Armed with the necessary resources the C. R. Bank can, by the pursuit of the well-known foreign exchange methods secure the stability of the external value of the domestic currency. The sales and purchases of both the domestic currency and foreign currency, the perfection of the forward exchange market and the varying of the buying price of gold would enable it to steady and regulate the external or the exchange value of the rupee. There would be no failure on its part to stabilise the normal rate of exchange which ultimately depends on the relative price-levels of the countries.

CONCLUSION.

The logical outcome of above trend of reasoning would compel one to admit that stabilisation of exchange at any level of sterling exchange or gold exchange would be premature when there is no prospect of relative stability in international prices. Relative instability of international prices, viz., rising prices in agricultural countries and falling prices in the gold standard countries, would mark the course of our economic events. If a conjoint effort is made to secure rising world prices and avoid all rapid fluctuations altogether the time would arrive when

we can no longer allow exchange to take its own course. But the very adoption of the international gold bullion standard form by this country will give the substantial measure of relative stability of prices and exchanges and a close correspondence of local currency policy with that of the rest of the world. International prices, internal prices, and exchange rates will all be under control. India would have to wait for this day of internationalising of the gold bullion standard pursuing during the interregnum a policy of masterly inactivity in the direction of securing practical stability of exchange. Let exchanges be used as the shock-absorber. Let us not ignore the possibility of raising the international price-level by the united efforts of all countries. Let us consummate our best energies in bringing about a modest rise in the present-day world prices.

APPENDIX II(A).

The advantages of linking the rupee to inconvertible sterling at 1s. 6d. ratio are as follows:—

1. There would be an exchange bounty on Indian exports to other gold standard countries. As India's trade is more with gold standard countries than England there is a temporary stimulus at least as a result of this exchange bounty on Indian exports to these countries.

2. The Government of India will not lose anything in the payment of sterling obligations. If a fall in the rupee-sterling exchange value would take place it would increase the amount of rupees to be laid aside to pay the sterling obligations. Without stable sterling-rupee exchange the Indian budget would become a gamble in exchange.

3. Without linking to sterling the gold value of the rupee would fall to a very great extent.

4. The Indian market is secured to British exports as against the competition of manufactures of the gold standard countries. This tantamounts to giving Imperial Preference by back door methods.

5. An element of uncertainty in the trading relations with England which amounts to twenty-five per cent. of our total trade would be removed. The remitters also stand to gain by stable rupee-sterling exchange at 1s. 6d.

6. The rupee will depreciate, i.e., the internal value of the rupee falls, viz., prices of commodities will be rising.

7. The frantic attempts on the part of the Government to support 1s. 6d. gold value for the rupee would cease.

The disadvantages have to be considered—

1. Indian import trade with gold standard countries becomes impeded. As goods pay for goods the Indian exports will become ultimately restricted.

2. The changing of the currency standard is a violent breach of national faith. The gold standard countries are justified in considering this step as the betrayal of national trust.

3. This gives an excellent opportunity to secure long-term credits and pay off sterling obligations out of the funds for sterling has become depreciated in terms of gold. This attempt to pay off sterling debts as the result of concerted action would tend to depreciate sterling further. The real sacrifice to pay external debts would still have to be made by this country.

4. There would be the flight of capital for there is lack of confidence in the rupee and the Indian monetary system.

5. It is a sad mistake to maintain the standard of value with the incidental and varying circumstances of exchange.

6. Unless an embargo on gold is placed India would be drained of all its gold stocks.

7. It places India at the mercy of currency and credit changes in England. This monetary subordination to the foreign centre turns out to be misplaced reliance in the long run as soon as sterling depreciates further and further.

Although the advantages of linking the rupee to sterling have been widely discussed much emphasis has not been laid on the consequences resulting out of linking the rupee to gold.

1. Trade with gold standard countries would not become handicapped if the rupee's gold value does not become altered. No uncertainties in trade matters with these gold standard countries would arise.

2. The rupee might not depreciate in terms of gold if left to itself. It is inability to discharge gold obligations that might bring about this contingency. But there is not much need for great credit amounts to pay off the gold obligations.

3. Unless a solid link to gold metal is established the Indian public will have no faith in the currency standard by whatever name it goes in academic discussions. There is nothing so dangerous as lack of confidence in the currency standard. The flight from the rupee would take place when the people think that the rupee is doomed.

4. If the gold rupee were to rise in terms of sterling there would be exchange gain. Sterling obligations can be paid with lesser number of gold rupees.

5. Remitters also stand to gain if the gold rupee were to appreciate in terms of sterling.

6. When sterling rises to its gold parity the rupee-sterling exchange can be stabilised once again.

7. Stable exchange between England and India does not mean stable international commerce for India trades with the other countries of the world.

The disadvantages of linking with gold would be as follows:

1. Inability to discharge gold obligations will tend to depreciate the gold value of the rupee.

2. If there were to be no immediate depreciation of the rupee the exchange bounty to Indian exporters will disappear.

3. Prices of commodities would not have arisen if the *status quo* had been maintained by linking the rupee to gold at the present ratio of 1s. 6d. gold.

4. If 1s. 6d. gold value for the rupee could not be maintained during 1929-30 it means that the rupee's real gold value is high and has to be depreciated.

5. There would be the draining away of the last ounce of gold from India if it were to bolster up an onerous ratio of 1s. 6d. gold for the rupee.

6. The Imperial Preference to the British exporters will still exist in this case for the sterling stands depreciated in terms of gold. Exchange dumping from England would still exist.

7. India would have no credit if the rupee is not linked to sterling.

If exchange were allowed to go adrift, *i.e.*, if the rupee is neither linked to gold nor sterling there would be the possible advantages and disadvantages arising out of this step.

Advantages would be as follows :—

1. The dangers of tying ourselves to inconvertible sterling currency would be removed. It would fall or rise to the normal level and get steadied according to the relative price-levels of the trading countries.

2. Exporters and importers would attempt to shift the risk of fluctuating exchange levels to exchange dealers who will make a genuine attempt to balance the gains and losses. Forward contracts with Exchange Banks can eliminate these risks.

3. Stability of exchange is an international task and when so many countries are off the gold standard an era of unstable currencies and a wilderness of exchange rates would ensue. Our exchange stability would become impossible under such economic conditions.

4. There might be no frittering away of resources. What might be lost in maintaining the gold value for the rupee might be compensated out of the gain arising in the direction of maintaining the rupee-sterling exchange.

5. Trade can flourish even in days of exchange instability as it did in 1872-1892 and 1921-1925.

6. It would be free from the charge of official manipulation of internal prices for the maintenance of an impossible ratio of exchange.

7. A policy of relatively stable internal prices giving uniform purchasing power for all classes can be pursued and exchange allowed to follow its own course.

The disadvantages are as follows :

1. Currency experts, realising the tendency of gold output to be smaller than world's monetary requirements have been foreshadowing a fall in prices. Under this contingency the maintenance of 1s. 6d. gold value for the rupee would be impossible. Sir Basil Blackett's gamble in rising prices proved a failure. Devaluation is inevitable. This policy of exchange instability arising under this contingency would add to the troublous situation.

2. Present business disturbance and economic depression would be heightened by exchange instability.

3. It would be enlightened selfishness and not mere philanthropy even towards England if we fail to accept the verdict of the Secretary of State in linking the rupee to sterling.

4. It will not check the flight of capital but nothing can check this tendency for capital like water tends to find its own level.

5. There is a sterling loan maturing in January 1932. It would be impossible to pay this without the necessary external credit or supply of gold credits.

B. RAMACHANDRA RAU.

APPENDIX III

SOME SALIENT LESSONS FROM THE FOREIGN BANKING SYSTEMS AND THEIR APPLICATION TO INDIA PROPER.*

SUMMARY.

In this essay are set forth some of the salient lessons that this country can hope to learn from some recent happenings in the foreign banking systems. With the problem of starting the Central Reserve Bank in the foreground of the banking reconstruction plan, certain other lessons which ought to be borne in mind are pointed out. There can be no overhauling of the banking structure without the creation of the Central Reserve Bank. An elastic system of rural credit and proper specialisation in the field of credit must be some of the important aims of the banking reformer who seeks to overhaul the banking structure. A banking system without the C. R. Bank is like Hamlet without the ghost. But an erroneous start in the organisation or the working of the credit policy or the aims of the C. R. Bank would taint and pervert the whole of the banking system. The difficulties in its path must be overcome by skilful banking practice and it will not take a long time to appreciate the usefulness of the C. R. Bank. Its immediate achievements might not be very tempting and its immediate success might not be assured, but by patience and perseverance alone can the Reserve Bank evolve into a useful organisation, as safe and steady as the Bank of England itself, and maintain the currency and finance of our country in a state of stability.

* A paper submitted to the Indian Economic Conference and this was published in the *Indian Journal of Economics*, Jan'y. 1931.

THE CONNOTATION OF THE TERM "BANK."

Surveying banking institutions from Japan to England, we discover that banking business is not the same everywhere nor is it so static and fixed as some of the observers of the banking systems are apt to consider. Banking business is of slow evolutionary growth. While the word "Bank" has received an extensive and wide connotation on the European Continent and Japan, the modern English Bankers still pin their faith to the conservative and old-fashioned idea that "banks should provide money and not capital." This, at any rate, is the bounden duty of the commercial banks. But a society requires other types of banking institutions to complete the financial machinery which its manifold activities require. Until now Indian banks have been slavishly following the English Banker's conception of his duty. Nothing is more important than to fill the gap in the monetary field arising out of the banks confining themselves to commercial banking alone.¹ Either a change in the conception or an extension of the connotation of the word "Bank" is essential. Mere extension of the duties of the commercial bank without due precautions is dangerous. Some of the co-operative credit societies who have combined the granting of long-term loans along with short-term loans have found out much to their chagrin that the cultivators required long-term loans alone, even for *bona fide* short-term needs. When the mentality of the Indian borrower is such, it is inadvisable to allow one and the same credit institution to perform both the purposes, viz., the provision of loans for short as well as long-term purposes, however cautiously it might propose to

¹ Specialisation has extended so far in the U.S.A. that we meet with banks started solely for financing certain industries alone. Quite recently the Continental Bank of New York decided to increase its capital and finance the broker's requirements and thus pave the way towards stabilising call money rates and the collateral loan market rates. About 350 stock exchange and curb houses hold the stock and the directors are all representatives of the brokerage houses.

conduct these operations. An elastic rural credit system both for short as well as intermediate and long-term purposes would be essential to complete our banking structure. Every banking system, including the English banking system, has now made systematic provision for elaborate long-term provision of capital to agriculture and industries. India, being predominantly an agricultural country, cannot afford to postpone the adoption of this essential and useful feature.

A CENTRAL BANK OF ISSUE.

Excepting Canada, where a Central Bank of Issue does not exist, all important banking systems have a Central Bank of Issue acting as the guide, friend and philosopher of credit institutions. Whether designed as a pure Central Bank or allowed to act as a Commercial-cum-Central Bank, the main duties of the Central Bank are to gather a big monetary pool, pursue resolute monetary control and bring about expansion and contraction of credit so as to maintain healthy conditions conducive to the prosperity of the traders and the general public. Admirably fitting itself into the gold standard monetary organisation it controls the gold movements into and out of the country and protects the gold standard system from the evil influences arising out of a gold efflux or influx.

So far as the general features of these Central Banks are concerned they are the depository of the reserves of the other banks and the reserves of the Government. They are custodians of the national gold stock and the supervisory monetary policy is greatly facilitated by this watch and ward over the entire gold resources of the nation. Acting as the Government Banks they manage the public debt, make disbursements on behalf of the Government and lend money to it within limits laid down by the legislatures of those countries. The discharge of these duties confers prestige and undoubtedly adds to their earning capacity.

A survey of their actual operations would enable one to realise that there are three types of Central Banks. The Continental type as typified by pre-war German and French Central Banks which conducted private business in competition with the commercial banks. Both the Reichsbank and the Bank of France performed these banking operations in several places and they acted as banks of deposit, discount and issue to the general public as well as the banking institutions.

Opposed to the above mixed type of Central Bank stand the modern Federal Reserve Banking System and other Central Banks created after its model. The pure Central Banks as they are often designated regulate credit and currency and rediscount for member banks alone and do nothing else. They have business dealings with the Central Banks of other countries.

Midway between the two types stands the Bank of England. It regulates credit and currency and mobilises the national gold stock in its hands. It has important private business of its own not only with the Central Banks of other countries but with the general public, the Government and the commercial banks. Through the bill-brokers it carries on its expansive and contractive side of its operations. Its open market sales and purchases of securities make the bank rate effective. All these types of Central Banks have one comprehensive programme of social utility and they propose to achieve this by altering the discount rate and trying to exercise through it, certain amount of influence on the price-level and the stabilisation of the business life of the country. Discarding the old gold basis as the sole regulator of their discount rates they are using varied economic data to regulate their credit policy and this new orientation of their credit policy is such that it forces even the pure Central Banks to enter the money market and by means of their "open market operations," *i.e.*, by buying and selling securities they

attempt to establish a close touch with the country's credit conditions and secure effective control of the money market. Almost all the Central Banks realise that they are not "mere dividend-paying machines, but nobler and higher instruments endowed with altruistic motives which inspire them to perform the sacred task of regulating credit and currency and managing the gold standard in the wider interests of the country." The aim of earning dividends for the shareholders has everywhere been subordinated. As Governor Strong of the F. R. Bank of New York says, "Earnings are not an influence in fixing the credit policy" of the F. R. Banks. Such an enlightened ideal governs the actions of the different Central Banks. Though Commercial-cum-Central Banking is pursued, the substantial duties and operations with the public do not go much further than the one of earning its own expenses and securing a mere reasonable profit to its shareholders. Another cardinal function of the different Central Banks is "to save the public at the right moment from the ruin which might result from the blunders of the private banks." So far as ordinary duties are concerned "the Central Bank performs the same benefit for the daily traffic in the banking world that the pneumatic tyre does for the motor car. It cushions the bumps and makes the whole service easier, smoother, speedier and more efficient."²

While the above are the functions of a Central Bank and the performance of which would entitle any bank to be considered as a Central Bank, there is now much uncertainty as to the proper manner in which the Central Bank has to be organised and managed. When even private Joint Stock Companies consider it important to maintain national control and not allow themselves to be managed by foreign investors, there ought to be some hesitation in an economically undeveloped country in the matter of organising a shareholder's

² See Governor W. H. Clegg's article on "Central Banking in South Africa," *Economic Journal*, December 1929, p. 532.

type of the Central Reserve Bank.³ The limitation of voting rights to nationals and national corporations and discarding foreigners as directors unless approved by the majority of the Board are some of the methods pursued to eliminate the undesirable influence of alien shareholders. Another useful move is that of the Marconi International Marine. It consists in setting aside the "foreign share" separately and allowing the foreign shareholder no privilege to hold the "national share" while the national shareholder can own the share even in the "foreign register."

The recent American invasion to secure control over British companies is being openly resented and several of them like the General Electric Company, are not allowing the foreigner to acquire the majority of the shares so as to secure control over its policy.⁴ When the Central Bank has to discharge important national duties there is no reason why foreigners should be allowed to have the controlling voice.

To eliminate all such undesirable influences, the method of starting a Central Bank by issuing public debentures guaranteed by the Government gives a convenient handle. Though the idea of a mixed State Bank is thoroughly familiar to the Indian public, yet it introduces or gives scope to the Government to exercise political pressure on the Bank. Considering the fact that throughout the world the executives of the Central Banks are being made free from political pressure and independent enough to pursue national policies, there is no wisdom in hankering after the old and almost forgotten ideal

³ A more thorough statement as regards the advisability of the particular type or organisation of a Central Bank will be found in my *Present-Day Banking in India*, Chapter on the Central Bank of Issue.

⁴ The Imperial Airways Co. of the United Kingdom excludes totally all foreigners from holding shares. See also the *Literary Digest* which says that "one after another of the British Companies whose securities have been made active by American buying are meeting hastily and amending their charters or bylaws to provide that control can never go overseas and that a majority and frequently all of the directors of the Corporation must be born British subjects." March 30, 1929.

of a mixed State Bank. If the shareholders' type of a Central Bank is undesirable for, without a clause which introduces racial discrimination the restriction over foreign control cannot be exercised, it has to be given up. The State-owned and State-managed Bank, being also undesirable, it easily follows that a stockholders' bank would free it from all dangers arising out of a defective constitutional organisation of the Bank.

All Central Banks display an international mentality and a rapid development of this needed mentality cannot be engendered by a purely State-owned or mixed State Bank or a Shareholders' Bank. A stockholders' bank under the capable guidance of experienced bank officers would easily develop this mentality and stand ready to co-operate with the executives of other countries and bring about the international financial community of interests. The idea of world peace can thus be better established indirectly by this method than by any other direct move such as the proposals for disarmament of navy, army, etc. It leads to a disarmament of the mind and is bound to succeed.

THE CASH RESERVE OF THE CENTRAL BANK.

War-time and post-war experience shows us that the reserve of a Central Bank can be far lower than the legal reserves when no gold is seriously intended for internal circulation. Gold is now intended for mere export purposes and the national gold stock that ought to lie in the hands of a Central Bank should depend purely on the balance of payments. As gold will be called upon to pay the unfavourable balance, it ought to bear a proper relationship to this alone. But in actual practice all Central Banks fix a relationship between notes and deposit liabilities which are "unrelated and this is clearly meaningless" says J. P. Colbert.⁶ Both the fiduciary and proportional reserve systems are meaningless as

⁶ See the *Statist*, Jubilee No. 1928, p. 39.

applied to the Central Bank. A low proportional reserve or a high maximum for fiduciary reserve is essential to give elasticity to the note-issue. Any other legal reserve regulation would be stringent and would heighten the demand for gold on the part of the Central Banks of the world. A falling supply of the world's gold stock would result in bringing about deflation. Gold would tend to become exalted as the master, instead of being treated, deservedly, as the servant of mankind. To reduce and remove altogether such undesirable consequences the gold reserves ought to bear a fixed proportion say a fixed multiple of the volume of trade and if this proposed idea underlying the Central Bank's reserve were to be accepted the international gold centres have to maintain higher stocks of gold than the above so that this free margin of gold would allow them to play the rôle of international financial centres.

Though the rational basis of the above suggestion can be easily understood no nation has adopted this principle in the formulation of the cash reserve basis of the Central Bank.*

Elasticity of note-issue without the danger of monetary inflation is the cardinal basis on which the note-issue privileges of a Central Bank are formulated. The fixed fiduciary principle now recognises the advisability of fixing this limit at as high a maximum as possible so as to cover all seasonal requirements without any alterations in the law. The expansion of this note-issue limit at times of panic is permitted and a periodic revision of the note-issue limit is also desirable to satisfy the changing requirements of the people. This is what the cumulative experience of France and England teaches us. All nations condemn any deflationary tendency underlying the note-issues when the trade demand is growing.

* Even our Gold Standard Reserve meant for stabilising the G. S. System is not based on this principle. It was discussed as the only safe basis for the fixing of the amount of the G. S. Reserve but was given up. Only £40 millions are now held in the G. S. Reserve.

They are equally emphatic in their declaration for checking any inflationary tendency which can be brought about by the issue of excessive bank notes. This is the reason why all countries which have adopted the proportional method of note-issue have carefully defined the nature of the assets which can give rise to the notes. They have jealously guarded the legal character of such notes and have promptly arranged for the due retirement of these notes.

This power of safe and elastic note-issue can be properly exercised by the discretionary capacity of the Central Bank's executive. So long as the Government does not create a note-issue of its own nor abuse the right of borrowing freely from the Central Bank of Issue the note-issue can be made safe and elastic at the same time by the wise management of the Central Bank. The war-time experience of the Central Banks amply demonstrates the truth of the above statement. The Bank of England succeeded very well simply because there was non-interference on the part of the State and when this was abused, as in France and Germany excessive note-issue became the rule. Dr. T. E. Gregory is essentially right when he remarks that "the Central Bank, which is an organ of economic self-government, implies that the State will neither print paper nor abuse its right of borrowing. As soon as these implications cease to be true, the power of the Central Bank ceases or vanishes."

Though some Central Banks pursued the policy of holding foreign bills freely in the days of currency interregnum, *i.e.* until the gold bullion standard was definitely established, the policy seems to swerve in the direction of strengthening gold reserves and the ultimate aim is to maintain exchanges at par by the use of bullion only, independently of any foreign bill reserve. Both the Central Banks of France and Italy have been pursuing this policy in the latter half of 1928. Too much should not be made out of this arrangement alone

¹ Quoted from the Jubilee Number of the *Statist*, 1928.

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and force the Central Bank of Issue of this country to maintain foreign exchange balances alone to settle the balance of payments:

Even England, the classical home of fluctuating bank rates, has adopted quite recently the policy of maintaining a steady bank rate irrespective of the gold stocks held by it. By virtue of pegging arrangements which exist between the bank rate and the deposit rate of interest all money rates become influenced by this policy. The maintenance of this policy stands as a token of its desire to help industrial and business reorganisation so badly needed to enable England to compete effectively with its rivals and maintain its predominant position as the world's greatest exporter of manufactured goods.

All economists admit that the general price-level of a country is susceptible to several forces operating from within the country as well as from without. The supporters of the doctrine of "managed currency" do not propose to straighten out this price-level by means of credit policy alone. The enthusiastic advocates of Central Bank management realise fully "that prices are not a stone wall which is quite immovable but they are not equally wax which gives away to every pressure." They realise full well that the price-level presents a strong resistance to all interference. They are aware of the fact that if undue pressure which is being exercised is increased beyond a certain point it is not the price-level that would decline but the withdrawn currency is replaced by some other less perfect substitute. It may therefore be recognised that the amount of monetary circulation is more feasible of alterations than the price-level itself. Hence the monetary reformers now believe that "it is easier to adapt the quantity of money and credit to a changed price-level than to modify prices by managing the circulation." All this is realised by the advocates of modern monetary reforms. They also believe that the action of the Central Bank should

be timely and however much its influence might be reinforced by other measures, the claim that it would promptly check business organisations from being overpessimistic or unduly pessimistic is not voiced by them. The open market operations might not be very efficacious⁸ and the bank rate would fail to carry full sting in the absence of a well-developed bill and short-term money market. It is only in a highly concentrated banking system that the arrangement of a centralised banking machinery would function well. But even there it might be true that a little more competition might be all that might be needed and the rigorous castigations of a Central Bank would not after all be the needed correctives or the panacea for the financial ills of each and every country.⁹

But it must be admitted that a timely action would go a long way in checking abnormal price and business fluctuations that are productive of so many evils to society. Relative stability of the price-level should be the objective of the Central Bank no less than the stability of the money rates.

Without stability in money rates industry cannot hope to flourish even if it were to be blessed with tolerable stability in commodity prices. Higher money rates generally tend to produce uneasiness in the stock market and place hindrance in the free investment of fresh capital. This is the lesson that the recent high money rates of Wall Street teach us (April and May, 1929). These variations in money rates not only tended to make the Stock Market nervous but induced higher money rates all over the world in order to defend their stocks of gold. Even India had to experience a seven per cent. bank rate on account of these higher money rates prevailing abroad.

⁸ This is what is realised by the F. R. Board itself during 1928 and many of its officials as well as critics discredit the "managing policy" of the F. R. Board. Officials as well as witnesses before the Select Committee on Banking and Currency admit that credit control is ineffectual and that it cannot stabilise prosperity." See the *Statist*, May 19, 1928.

⁹ See A. J. S. Baster, "The Imperial Banks."

FOREIGN CAPITAL.

The orderly flow of foreign capital through the financial institutions of the country mainly for the purpose of promoting industrial development and other developmental purposes has a favourable bearing on the foreign exchange market. Interest payment and dividend remittances may otherwise operate, but the whole process is an advantageous one tending towards the building up of national wealth. This is the recent experience of Japan, Canada and Germany. There must however, be a limit to the foreign borrowings or else interest charges would mount up to an inconveniently high figure and cannot be balanced through increased exports. Again another disadvantage might arise when the flow of foreign capital from foreign sources might be stopped all of a sudden. Germany had to experience such difficulties in 1928 when the American stream dried up on account of keener demand for speculation on the New York stock market. Germany had to fall back on London and France for securing the needed short-term capital. But when there is international tightening of capital, dependence on foreign capital would be suicidal. Germany realised this situation long ago and almost all countries have been making persistent efforts to develop internal capital markets so as to reduce their dependence on foreign capital. Japan, Canada and Germany are successful examples. Germany, in particular, knows the fact that German economy depends purely on the domestic capital market. The increase in savings deposits of the German depositors is often alluded to as an infallible sign of capital increase on the part of Germany. It is not after all a real sign of economic growth for it depends on higher wages and these reflect on the production costs of industry and capital supply to industry. Although high rates of interest were paid for the domestic loans very few German subscribers were to be found for the loans floated in the year 1928. The situation has improved to a certain extent but dependence on foreign

capital is not given up as yet. The German Banks have attempted not only to accumulate domestic capital but have made it their duty to intelligently co-operate with the creditor countries and secure the needed supply of foreign capital for the domestic borrowers. A prominent German banker says, "Capital is in its very nature international and only elemental occurrences in the political or other spheres can divert it from its natural field of activity. The movement of capital towards Germany can, in the long run, therefore, only be averted by Germany herself, if she pursues an erroneous economic policy, for it is not to be supposed that the atmosphere of international economic understanding, which is apparent to-day throughout the whole world, will entirely be dismissed in the near future."¹⁰

As British capital is of the type which takes all the risk and all the profit, it is better financial wisdom to lessen our dependence on it. The American capitalists insist on securing a fixed rate of interest. The South American conditions amply prove my statement. No wonder America's capital is increasingly employed in State Railways, public works, etc., and the socialistically inclined States are conducting the public utility services with the help of American capital. The lesson is apparent. We should allow Great Britain to act more as a banker (till the domestic capital market expands) to the Indian industries and less as a workshop supplying us with technical requirements. These would have to be manufactured within this country under Indian industrial legis. At present banking, insurance, shipping and personal services are being rendered to us for our raw materials and food products. In future banking, shipping and insurance services would be declining as Indian people would be rendering more active service under these heads than before. If Indian domestic capital, which is of late taking some active part in commerce were to pursue this same policy towards industries,

¹⁰ Quoted from the Report of the Darmstadter Bank.

shipping and insurance the economic self-sufficiency and progress of the country would be facilitated. Like the socialistic States of Argentine and Australia our States should aim at securing foreign capital mainly into the fixed interest-bearing type of investment reassuring the larger share of the profits for the whole community by the State-ownership of public services.

THE INTERNATIONALISATION OF BANKING.

The major commercial banks in most of the advanced countries of the world are fast tending to become international in character. The internationalisation of banking is being achieved in three ways: (a) by extending branches abroad, (b) by purchasing shares in foreign banks so as to acquire controlling interests, (c) by combining with other banks operating in the foreign area. Though in the pre-war days it was method (a) that ruled the circumstances increasing use is being made of methods (b) and (c) in the war and post-war circumstances. This change in method was due to the anxiety to avoid disturbing the national sentiment of the foreign country and the vested interests of the existing banks whose jealousy and antagonism would soon be roused. Method (a) is being openly pursued by the Imperial Banks and the Empire Banks in all those countries where political power and economic penetration cannot be openly resisted by the colonies or undeveloped regions belonging to the Empire. The major Imperial Banks of England, France and Japan have branches in the colonies, spheres of interest and mandated territories. Method (a) is now being attempted by the big American banks with a view to get themselves represented in the big financial centres as London, Paris and Berlin so as to be able to afford all-round banking facilities (including tourist traffic) to their customers.

France pioneered the way in adopting method (c) and in the Central and Eastern European countries banks were revived by the foreign capital lent by such affiliations. The

resurrection of the Wiemer Bankverein is an instance to illustrate this tendency. Great Britain pursues the self-same tendency and has established the British-Italian Banking Corporation which conducts its business through its allied institution the Banco-Italo-Britannica. The big five, with the exception of the Midland Bank, have also adopted this procedure.¹¹

Indian trade in the Far East can be developed by adopting this method and enrolling the services of foreign banks to help the Indian banks interested in extending the export trade of the country. The big selling units of the major staples should request their banks to bring about such a desirable innovation and the financing portion of their business, the selecting of reliable foreign merchants to act as agents for the sale of goods and a reliable knowledge of the state of credit and domestic circumstances can be secured through such a channel.

BANKS AND SPECULATION.

It is oft stated that "John Bull can tolerate anything else except a two-and-half per cent. bank rate." He would fall a prey to speculation during the days of such artificial prosperity. It is part of human nature to forget the lessons of the past. When too great indulgence in optimism and speculative venture is taking place a sharp rise in money rates would be no successful antidote and any manipulation of the bank rate is apt to fail. Danger to business stability would result out of such an injudicious attempt. The exuberant temper of a speculative community will not fail to respond to a sufficient stimulus in the way of cheap and easy money arising out of a glut of savings. The banker's duty is to attempt to deflate speculation, if possible, by drawing a difference between the speculative and the legitimate borrowers, viz., pursue a careful policy of loan rationing. This laudable attempt to supply the

¹¹ See A. J. S. Baster, 'The Imperial Banks,' Last Chapter entitled the Integration Movement.

vital and essential needs of society at the old favourable rates would certainly be defeated by the re-lending of bank credit at higher rates to the speculators or if "outside" money were to be lent to the brokers for speculative purposes.¹² A differentiating and discriminating rate attempting to penalise speculation would not go a long way in checking speculation. The virtue of attempting to protect the innocent and penalise the offender underlies this attempt to ration credit in an intelligent manner. Whether it would succeed in checking speculation or not, it becomes inevitable in some form or other, for an all-round rise of the money rates would only result as the well-known paper the "Economist" puts it, "in penalising the innocent without troubling the guilty." Every other method would be equally futile. Moral persuasion on the part of the Central Bank, its open market operations and differential rediscount rates and the cutting off of foreign bank funds from the money market by the curtailing of private lending in Wall Street by the New York Clearing House have all been tried and found wanting. They proved futile, as the "boot-leg money" placed by the corporations served to stimulate speculation and the cardinal lesson which the recent American speculation crisis so admirably teaches us is that the bank's discount rate is not all-powerful to check the rise in prices or turn an unfavourable exchange rate to a favourable one or restrict the creation of abnormal credit or check speculation which might be engendered by some cause or other. This is what present-day American banking policy teaches us. Speculation has been aptly compared to fever and like fever it must cure itself.

Another grave lesson which the recent wave of speculation in America can teach us is as follows. The American banks

¹² It failed as a result of the influence of the bear contingent, an increase in unemployment and reports of poor earnings for 1927. The raising of the bank rate undoubtedly gave the first blow to the speculation bulls. The high rediscount rates and the credit control policy tended to make the bulls "red and feel groggy but the toughest blow" came as a result of the above set of circumstances.

suffered greatly on account of embezzlements on the part of the bank officers. The stolen bank money was usually lost by selling short in the bull market. The bank tellers, who were the chief offenders, failed to place funds deposited during the day and the higher executive officials engaged in the same kind of business could not hope to check the actions of the bank tellers.

Quite recently we have come across instances of embezzlement of bank money in our country on the part of the bank officers. Such unfortunate moral delinquencies arise in every country and are solely due to the attempt on the part of the bank officers to live beyond the means of their income or downright dishonesty or speculative gambling with the help of bank's money. Insufficient salaries and the attempt to start outside business in addition to bank duties or other unfortunate hardships generally account for most of the cases of bank embezzlements. The only practicable manner or way of combating this dreaded evil is to appoint responsible officers, only after a thorough investigation of their past history. These can be bound down to furnish sureties. Periodical audits by recognised and capable auditors and the introduction of mechanical appliances to do accounting work would go a long way in eliminating these dangers. Internal audit on financial transactions would be useful and enable one to detect the defalcations early. This is what American banks failed to do and that is why they suffered to such an extent by the huge sums defalcated by the bank clerks. Indian banks ought to understand this much from the recent wave of speculation in the American stock market.

BANKS AND PUBLICITY.

The Indian banker must give up his attitude of dignified silence. He should no longer be a silent observer of public affairs keeping his pulse on them but it is not mere talking for

public edification that is essential. He should step into the public arena and begin to educate the public by his illuminating addresses on trade, and economic circumstances of the country. The practice of the Bank Chairmen of the "Big Five" has to be emulated. They should not only answer all enlightened or mischievous criticism of their actions but point out the paths by means of which industries can get rid of their difficulties. Besides long and interesting statements of the business of the banks, an intelligent commentary on private economy, public finance and credit and important financial events having world-wide significance should be found in their annual reports.

Similarly, the Central Bank of this country should issue informing balance sheets and now that the 'paragon of conservatism'—the Bank of England which could dare to defy public opinion so long and continue publishing enigmatic balance-sheets for nearly three-quarters of a century has come forward to publish informative balance-sheets, the case for for publicity receives undisputed strength out of its action. The amalgamation of note-issues has proved to be a significant achievement in several directions. The most important thing is the issuing of a bank return supplying additional information. As the right Hon'ble Reginald McKenna says "In the return of the Banking Department the total of the British home bank balances, hitherto undisclosed, is now shown separately as a part of other deposits, while 'other securities' are divided into discounts and advances and securities. These items, as the records increase in length and as experience is gained in their utilisation, will add materially to the value of the statement for short and long term purposes."¹³

¹³ See, "A Picture of World Economic Conditions at the Beginning of 1929," p. 103, issued by the National Industrial Conference Board of the U.S.A.

BANKS AND THE EXCHANGE MARKET.

It has now been recognised in all countries that a forward exchange market is essential for exchange stability. Abnormal methods of controlling exchange rates have been found to be ineffective. The stabilisation of exchange is a thing that tends to establish itself and without such stabilising conditions it is impossible for a long time to restore sound conditions. In the advanced countries the perfection of the forward exchange market had become so complete that it actually dominates the spot rates and in case of the sterling-dollar rates we witness such a phenomenon. The widening of the exchange market, the specialising nature of the exchange brokers and the necessity on the part of the merchants to realise that it is wise to eliminate exchange risks apart from trade risks are the predominant factors in the case of an established forward exchange market.

The financing of foreign trade itself must be done with domestic funds and it is the bounden duty of the Central Banker to indirectly secure this ideal through the intervention of the existing joint-stock banks or those specially created for that purpose. Both the United States of America and Japan, the latter to a less degree than the former, have succeeded in developing suitable banking machinery to finance their own exports or imports with the help of domestic resources.

BANKS AND THE INVESTMENT MARKET.

The perfection of the investment market in almost all advanced countries is a patent fact. America, Japan and Germany stand as outstanding examples of recently organised banking systems where much attention is being paid towards the mobilisation of the domestic capital resources of the country and the investing of the same in safe and remunerative channels by special institutions known as investment trusts and these divide the risks by spreading the investment over a wide area and thereby secure better outturn than

what a single individual, however enlightened he might be in the art of securing safe investments for his capital, can hope to do. The increase of capital is not the main problem but the safety of the existing capital is the sole criterion. Circumstances might force us to borrow in the foreign countries but the rebuilding or renaissance of the domestic investment market must not be forgotten. The creation of an organisation for the mobilising of the domestic capital resources should not be postponed any longer.

APPLICATIONS OF THESE LESSONS TO INDIA PROPER.

While some of the salient lessons underlying the discussion have been pointed out already it is essential to frame permanent reconstruction of our banking structure in the light of the most important of the above conclusions. It is assumed that the formation of a Central Reserve Bank and the creation of an elastic rural credit system are indispensable parts of a larger problem, namely, the reform of the entire banking structure. Everywhere else, the bank note-issue, i.e., bank currency forms an integral part of the credit structure. Our plans of banking reconstruction have to be worked out more or less with reference to the plan adopted for the currency reform.

It is difficult to imagine how banking reform can be accomplished without empowering the Central Bank to issue elastic notes which form no meagre part of the total volume of money in the country. Considering the advisability of making bank notes rise or fall in response to the needs of business the first item of our banking reconstruction is to deprive the Government of its control over note-issue. The issue of new notes must be in the hands of a Central Bank. Observing the favourable experience of other foreign countries with asset currency it is essential to issue notes based on the assets of the Central Bank. To ensure confidence in the minds of the public they might be Government-guaranteed.

notes but they must be directly issued by the Central Bank. The asset backing for the notes may be gold and collateral paper such as commercial, agricultural and industrial paper. The proper combination would be 50 per cent. which happens to be the prevailing law in the matter of our paper currency organisation. Having the privilege to issue notes based on gold or commercial paper it can be left to the discretion of the Central Bank to issue notes either on gold or commercial paper as the management thinks it proper to do. The form of eligible paper might be—

1. Notes, drafts, bills of exchange or acceptances issued or drawn for agricultural, commercial or industrial purposes and rediscounted by commercial banks at the hands of the Central Bank.

2. Open market operations or purchases by the Central Bank consisting either of bills of exchange indorsed by a joint stock bank or of banker's acceptances, which at present do not exist to any extent.

3. Notes, drafts, and bills of customers drawn for the purpose of carrying or trading in bonds and notes of the Government of this country or the United Kingdom and rediscounted by the Central Bank.

4. Promissory notes of the commercial banks to run not exceeding three months secured by (a) commercial paper eligible for rediscount, or (b) Government securities.

Such terms of note-issue which have been outlined above would undoubtedly confer the needed elasticity required by either business or Treasury finance.

To meet sudden emergencies this law can be suspended and additional note-issue can be permitted on the payment of a graduated tax. The discount rate at such times must be made to rise by an amount equal to the tax paid by the Central Bank. Such provisions will satisfy the needs of a crisis or any unusual emergency. Automatic contraction

can also be provided for by the increase of tax and discount rates. By this feature we are incorporating the German and the English devices of creating excess issue to meet emergencies.

The redeeming of these notes at the Central Bank or the Treasury must now be discussed. Both in the pre-war France and the United States of America the Central Bank had the power to pay the notes in gold or silver, as in France, and gold or lawful money, as in the U. S. A. In the future, when gold shortage is to be an accomplished fact, the concentration of gold in the central reserves would be highly useful and a provision of this character would be highly useful in protecting the gold stock in extraordinary times. While this privilege would thus be helpful the question of keeping notes at parity with gold and speedy exchange of notes for gold or gold for notes should not be interfered with in ordinary times.

As the general public of our country do not understand the subtle distinction between legal tender and optional tender it is better to confer the legal tender quality on the notes of the Central Bank. It is undoubtedly true that a proportional note-issue has the possibility of inflationary demand attached to it and to curb this tendency the legal tender privilege for private debts might be denied as has been done in the U. S. A. But even there banks and the government exchange the notes for lawful money at their full face value.

Coming to the actual measures needed for securing automatic retirement of notes which is so essential for contraction purposes, it must be borne in mind that the issue of the One Rupee Note makes it difficult to insure prompt retirement. Large denomination notes would generally float back to the Bank easily but the smaller denomination notes generally are not retired early. The conferring of the legal tender quality would again stand as an impediment to the prompt retirement of the notes. Even banks would be holding these as

part of their legal tender reserves. Although the F. R. notes are not legal tender, yet these are not issued below denominations of five dollars. As inter-district movement and payment of them by another F. R. Bank other than the issuing bank is subject to the penalty of a 10 per cent. tax the feature of automatic redundancy is supposed to be completely effective and to reinforce it special powers are conferred on the F. R. Banks to refuse rediscounts to member banks and compel them to repay old borrowings by returning currency i.e., notes. The F. R. Board has the power to levy interest tax on note-issue backed by non-gold collateral. Next, the rediscount rate may be raised by the F. R. Board, if it finds the note-issue over and above the legitimate demand requirements of business. Lastly, it employs the open market operations on the part of the F. R. Banks to bring pressure and compel the safe retirement of these notes. Thus the chief lesson one has to learn is not to place blind faith in the doctrine that notes find an outlet only when there is legitimate demand for the same and nothing in the direction of enforcing note-retirement is essential. Although notes generally find an outlet through business requirements alone, the necessity to automatically retire these notes as soon as the requirements are satisfied is often overlooked and at such times the Central Banker must be endowed with power to exert pressure on the ordinary banks and secure contraction of the notes. But unfortunately this side of the note-issue provisions, which is meant for contraction purposes, is often neglected. It is not enough to merely lay down regulations checking monetary inflation through note-issue. Just as elasticity should be secured, whatever the state of the gold stock might be, so also the contraction must be managed with a view to save the community from excessive and highly inflationary size or amount of the note-issue. These are the principles on which the note-issue of our Central Bank should be managed and without having an elastic note-issue in its hands which does not at the same time lead to monetary

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inflation, satisfactory rediscounting of the eligible and qualified paper would be sometimes impossible and the genuine credit demands might not be satisfactorily complied with.

BANK RATE.

It has already been laid down that a lower and more steady bank rate than the present one should be the ideal aimed at. Considering the last half-year's (ending Dec. 31, 1929) bank rate, the average was 5.788 per cent. as against the previous half-year's average of 5.456 per cent. It would indeed have been higher if trade demand had been felt. Depressed trade and the stagnant industrial situation in the cotton industry of Bombay and the slowly falling prices of country produce needed lesser finance than as usual and there was no borrowing of emergency currency from the Controller of Currency at any time. The seven per cent. bank rate reached in October, 1929 would not have been imposed on the banking system, but for high bank rates ruling abroad and the investment of Indian money abroad. The heavy Treasury Bill borrowings must also have told their tale in this matter and raised the bank rate to seven per cent. One unique feature, however was the low money rate prevailing in the money market in spite of the above advance in the bank rate.¹⁴

This situation would necessarily have to be changed as soon as the Central Bank assumes charge of the currency and credit policy. This Central Bank should remove the influence of the Government on the bank rate. Any undue raising of the bank rate to eight per cent. as was done by Government pressure would have to be checked. The present-day peaks and valleys of credit fluctuations would be smoothed out as a result of the Central Bank's operations. Its true financial wisdom would enable it to stand prepared for unforeseen,

¹⁴ See the Half-yearly Report of the Imperial Bank ending December 31, 1929, published in the *Englishman*, February 3, 1930.

abnormal and unexpected contingencies, though they may be purely non-Indian in origin and character. With the successful financing of the Treasury's requirements by the policy of Ways and Means Advances one reason for unduly pushing the bank rate to a high level would be removed. With an elastic note-issue the seasonal requirements can easily be satisfied at a steady level of the bank rate. Changes in international finance would undoubtedly have a repercussion on the Indian money market. The best way to meet such abnormal contingencies is to provide the shock-absorber—the Central Bank.

Lacking absolute autonomy and devoid of sufficient resources the Imperial Bank could not withstand any of these extraordinary shocks. Neither the internal situation nor the complications arising out of international financial stringency could be satisfactorily handled by the Imperial Bank. Often when trade demand was acute the cash balances used to reach a low figure of thirteen per cent.¹⁵ The issuing of emergency currency at such times against *ad hoc* securities or the transfer of the Home Cash Balances to the Indian counterpart by placing sterling securities in the P. C. Reserve and issuing P. C. notes against the same, thus augmenting the Government cash balances in the hands of the Imperial Bank or the manufacturing of bills to secure their rediscounting at the Controller's hands was often resorted to on several occasions. These medieval methods of finance have to be scrapped as early as possible. It is high time that the seasonal emergency or cyclical or secular and abnormal needs are properly looked after. All Central Banks are now armed with the privilege of note-issue and their purposeful credit policy even in normal times is so directed as to enable them to tide over the cyclical period with the least possible disturbance. Seasonal needs can be adequately provided for by

¹⁵ The lowest record to which the cash reserve proportion of the Imperial Bank has ever fallen was 9 per cent.

mere expansion of book-credits, i.e., deposits and notes and no penalty bank rate is ever inflicted on the businessmen. The proportional system of note-issue which is backed by commercial paper, can duly empower the Central Bank to meet the needs of seasonal as well as cyclical emergencies. But no modern banking system is being so managed at present as to secure the secular stability and stabilise prices in the long period. In an abnormal contingency as war, all the three expedients of loans, external as well as internal, the screwing up of the rate of taxation and the resort to note-issue would be inevitable. The more costly the modern war is the more effective must be the three methods of war-finance.

DIFFICULTIES OF OPEN MARKET OPERATIONS.

It would be mere folly to minimise the real dangers which the Central Bank would have to experience in the early days of its existence. The financial good that it can hope to render would not be very prominent from the very beginning. The immediate changes that it would bring about must be studied. It would necessitate the transfer of note-issue powers at present exercised by the Government of India.

Secondly, it would involve a cataclysmic change so far as rediscounting of *hundies* or "manufactured" bills by the Controller is concerned. The rates charged for this rediscounting have varied from six to eight per cent. To substitute merely for this purpose a Central Bank would be unnecessary for oftentimes there had been no such rediscounting at the Controller's hands even at the time of the busy season. During the present season (February, 1930) there has been no creation of this emergency currency thus far. Money rates are easy and though up-country demand might be felt sooner (February, 1930) or later it is quite likely that this demand would not be made by the Imperial Bank.

Thirdly, the lack of a discount market and the absence of bill habit need not be commented upon. But unless a

Central Bank helps this process of perfecting the short-term money market, the development of the same would never take place within a reasonably short time.

Nextly, the demand for loans in an agricultural country would be inelastic and discount rates can never hope to exercise effective control over the situation. As at present the bank rate of the Central Bank would be a mere symbol devoid of any real significance. For some time to come that would be its fate.¹⁶

Another reason pointed out elsewhere is the opposition of the Exchange Banks who would not curtail their dependence on the London Money Market either for rediscounting their bills or for investing their liquid resources in the short-term money market of London.

Still another dominating factor delimiting the usefulness of the Central Bank should be stated. Even in the advanced countries it is now being realised that immediate stabilisation of prices or business would not be forthcoming out of a judicious use of the bank rate or open market operations. Considering the "agricultural lag" fluctuating or changing price-levels would have more pronounced effect on the farmers than on the industrialists. However much the need for benefiting the farmer by means of a stable price-level might be felt still in actual practice it cannot be realised without other helpful factors co-operating with the Central Bank in improving the situation.¹⁷ The new gold standard itself is the best regulator of prices and any conscious stabilising of internal prices would mean continuous rigging of exchange up and down with reference to movements of world prices. As the different countries of the whole world have rejected the policy of stabilisation

¹⁶ See the Section on the Future of the Foreign Exchange Banks—Part of my written evidence before the Central Banking Enquiry Committee.

¹⁷ The success of the open market operations of the F. R. Board is much exaggerated and the helpful factors which pulled in the same direction are forgotten. See Lawrence, "The Stabilisation of Prices," p. 472.

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of prices by adopting a managed currency and have returned to the new gold standard the objective aim of this country should be to return to this new gold standard and consider it as a good enough measure for regulating prices.

If these are the real objections to the successful working of a Central Bank it can be pointed out that the main reasons why a Central Bank would be necessary in this country can be stated under three broad headings.

Firstly, the monopoly of the foreign exchange banks has to be broken down by helping the competing local exchange banks.

Secondly, it would prevent a recurrence of the 1913—1915 banking crisis. This prosperity crisis was due to capital being lent through banking channels for industrial purposes. When the knock came they found themselves in a peculiar situation and no one was willing to help them. Their inevitable collapse brought down a number of banks. The presence of a responsible leader rendering discriminating help could have saved some of the solvent banks. No worthy lead was given by the Presidency Bank of Bengal even though the Government was willing to grant aid. The lessons of this crisis unfortunately were lost and no tangible good, immediate or deferred, resulted out of this crisis. No amalgamations, no purification process, no reconstruction schemes such as those which followed the Australian Crisis of 1891 to 1893 have resulted.

Thirdly, an orthodox Central Bank whose functional simplicity might be rigidly adhered to would facilitate and improve the remittance business of the Government, provide the rediscount facilities for the commercial banks, manage the currency and credit system of the country and perform Government business on strictly intelligent principles. The most important innovation would be the rediscounting of *Jundies* by the joint-stock banks which is now considered as a weak sign and not resorted to by them.

This would enable the spread of the banking net far and wide. It would increase the scope of the Central Banker to exercise his power over the entire banking field. The slow popularising of the credit instruments, the encouragement of the deposit habit, the training of men fit to run banking institutions and the efficient handling of the banking system during the times of a crisis would be some of the immediate beneficial advantages arising out of a Central Bank of Issue. But to secure even these simple benefits it has to fight against tremendous odds the most prominent of which are popular apathy and ignorance and the jealousy of the foreign exchange banks. But if it pursues a bold, active, forceful and energetic policy there is no reason to doubt that it will eventually occupy its rightful place in the Indian money market as the corner stone of its currency and credit system.

APPENDIX IV.

A BANKER'S REGISTER.*

Nothing is so unfortunate as the lack of a suitable definition of the word "bank" and "banker" in this country. Neither the Indian Stamp Act (Sec. 20) nor the Bankers' Book Evidence Act (Sec. 2-2), nor the Negotiable Instruments Act, nor the Indian Companies' Act (Secs. 4, 136, 259) have attempted to fix the precise meaning that can be attached to banking. They attempt to interpret the word "Bank" in the sense of Banking. It is indeed as vague as the classical definition of Prof. Walker who defined money as follows: "Money is what money does." If the law fails to be very informing in this respect, the same lack of precision is attached to the use of the word "banker" in the ordinary nomenclature of "the man in the street". He generally understands the word "Banker" as a dealer in monetary credits. Even a mere interest-grabbing money lender who generally depends solely on his own large capital resources is often referred to as a banker. He does not shrink from exploiting the public by designating himself as a banker. Understood in its real sense and in the way in which it is often understood in the Western countries a bank must deal with other's money and receive deposits as a matter of ordinary business. Interpreted in this manner all indigenous bankers who refuse to deal with deposit business, itinerant money-lenders, and partnership money-lending firms would have to be excluded from the category of bankers, for they seldom conduct business on lines of modern banking which includes deposit-attracting and the payment of the same by means of cheques.

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BANKS AND THE MONEY MARKET

This anomaly has to be rectified, and without a careful definition of the word "bank" it would be indeed difficult to protect the public against usurious money-lenders, pure and simple. Again, the protection extended by the N. I. Act cannot be secured unless the word "banker" is clearly defined. The granting of certain privileges to banks and bankers to facilitate the successful performance of their quasi-public duties cannot be carefully done without an adequate definition.

The compiling of a register of banks and bankers is the only safe course that can be adopted under the present circumstances. The meaning of the word "bank" and "banking" can be understood in the Western sense. Those who receive deposits of money either on current accounts or on fixed deposit accounts subject to payment by cheque and the lending of money should be styled "banks" or "bankers". All these can be registered as banks or bankers. In an age, when every profession has this registration business done satisfactorily, the bankers cannot hope to place any real obstacle to the carrying out of this suggestion. Even the slow-moving Indian public have become familiar with the business of registration of professions such as doctors, lawyers and other learned professions. An independent body should be set up to prepare this register for admitting and rejecting applicants, always bearing in mind the above-mentioned business of banking and the circumstances of the business of the applicants. The general public would have to understand that the registration of banks and bankers is no certification or guaranteeing the probity and business capacity of the registered bankers. This seems to be the only common-sense solution which can be adopted in this country. Specialising banking institutions would necessarily be included in the register. These can be kept separated from the cheque-paying or commercial banks. The title of quasi-banks can be adopted to include the co-operative and other kinds of specialised banking institutions. The Burma

Banking Enquiry Committee* points out the adoption of this plan as early as possible. As a matter of fact it was Sir John Paget who initiated the above proposal in England and it was heartily endorsed by the leading bankers, such as the late Dr. Walter Leaf. A bill was drafted to bring about this register but it was not passed (*see* Sir John Paget—Law of Banking, p. 3).

Registration involves certain duties, the successful execution of which would entitle the bank or the bankers to obtain certain coveted privileges. Some of the duties would necessarily be the publication of statements, returns and accounts and the due auditing of the same by professional accountants. Some registered bankers or banking institutions should be granted facilities mentioned in the Indian Stamp Act, the Bankers' Book Evidence Act and the Negotiable Instruments Act. Facilities in discounting hundies and in remittance operation can also be granted to the registered banks by the Central Reserve Bank, if it were to be started. Membership to the clearing houses can also be thrown open. The local gazettes can be used by the tribunal for registration and dis-registration of the banks and banking companies. Annual publications of the registered list can be sent out to all without prejudice either to those whose names have been unfortunately omitted by oversight or making the Government liable, in case of failure, to deliver the list to the bankers. All foreign banking companies, which conform to the above definition of banking, can be registered by the tribunal as banking companies subject to the same obligations and restrictions as their Indian confreres are put to. Existing persons or companies recognised as banks and protected by the N. I. Act should not be deprived of the right of registration. This simple and clear procedure would eliminate the present misunderstanding of the meaning of the words "bank" and "banker." Those who do the business of a banking as an

* See pages 295-297 of its Report.

ancillary business should be excluded from the register, solely on the ground that the averaging of risks which is the main function of sound banking is solely neglected by them. Many of the private banks and private loan companies which undertake ultra-banking operations would likewise become eliminated. For instance, in Bombay, there are about 13 private companies registered as limited banks. There are several unregistered financial concerns conducting banking, along with such transactions as those of capitalists, financiers, concessionaries, and merchants, contractors, traders, and speculators. The door should be closed to such people as well as to the money-lenders, pure and simple, although they might be undertaking to keep fixed deposits to a small extent. Money-lending-cum-banking firms which undertake the keeping of current accounts and fixed deposits and agree to honour the cheques of their customers would, of course, be included in the Register.

The complexities of modern business generally get heightened if the term banker is not defined. Equally vexatious consequences result out of the present-day inability to define the word "customer". The older and narrower view prevalent in England was to consider anyone a customer if he had the recognisable habit of dealing in the nature of regular banking business. (See the decision in the case of the Great Western Railway *vs.* London and County Bank—1901). A stray and sporadic or isolated transaction with a bank does not entitle the party to be styled a customer. The wider and the latter-day opinion* is to discard the question of duration altogether as the essence of the customer's relation. The mere payment of a single cheque for collection entitles one to be styled a customer of a Bank. At present neither of the views are

* See the decision in *Ladbroke vs. Todd*—(1914). See also the Privy Council's ruling in the *Commissioners of Taxation vs. English, Scottish and Australian Bank* (1920).

adhered to and the opinion is fast gaining ground that a customer is one to whom the Bank delivers a cheque book and the moment the delivery takes place the relationship of customer arises between the Bank and the individual opening the account. Understood in this sense a customer is one who has entered into a contract with the Bank which undertakes to honour his cheques and to credit his account with the value of the cheques payable to him and handed over to the banker for collection. This is the best acceptable definition for the purpose of the Negotiable Instruments Act.

Such clear cut notions are necessary to let the public know who are the real bankers, and the bankers themselves ought to know what their duties are and what privileges are conferred on them. Finally they ought to know who their customers are and their duties and responsibilities to them.¹

¹It is a matter of gratification to note that Mr. V Ramadass Pantulu elaborates these conceptions clearly in his minute of dissent.- The Register should not be a "mere writ of restraints" but a "Magna Carta of their rights and privileges."

APPENDIX V

THE EXTENSION OF THE CO-OPERATIVE CREDIT MOVEMENT.¹

While criticising effectively the suggestion of the extension of the present-day type of the co-operative societies, attention has been drawn towards the necessity of making them realise the true and right spirit of the co-operative movement.² Real self-help, mutual trust, neighbourly help and corporate responsibility, which are the fundamental features of true co-operation, should pervade all actions from the procuring of credit down to the smallest line of economic activity of our people. The number and the variety of lines of co-operative activity in the field of associated human action should increase and the co-operative credit movement itself should be based on scientific lines so as to maximise the benefit and minimise the human efforts needed to secure these advantages and enable them to enjoy an honourable living.

Times without number, I have pointed out the disadvantages of the lack of specialisation in the domain of credit. But the suggestion for a joint working of the short-term and long-term loans on the part of the present-day co-operative credit societies, i.e., the Central Banks, is advocated afresh.³ Reference to existing conditions is pointed out as a justification for the recommendation. The example of "mixed banking" of Germany and the theoretical possibility of segregating the two lines into two distinct departments is also often quoted in support of this line of reasoning. Although

¹ Published in the *Indian Insurance and Finance Review*.

² See my "Present-Day Banking in India," Chapter on Co-operative Banks.

³ Most of the Banking Committees of the Provinces with the exception of the Bengal Banking Enquiry Committee have not wisely approved of this line of reasoning. It is indeed a few theorists, who wish to gain prominence for themselves, that advocate this idea for the reasons mentioned in the text.

these pros are weighty ones yet there are indeed many cons which have to be studied before this suggestion can be acclaimed as a useful one. Whatever might be the compelling necessity to grant long-term loans for making productive improvements on land or for redeeming mortgages such an unwise combination of two different lines of credit in one and the same hand is bad, illogical, and dangerous. That two redoubtably pernicious tendencies have resulted out of this attempt to dole out the two-fold lines of credit by one and the same institution has to be understood in this connection. Firstly, the tendency to demand long-term loans even for genuine short-term purposes has crept in.⁴ The prevailing illiteracy is such that the *right* use of credit at the *right* moment to the *right* limit is not understood by the people. Secondly, the co-operative short-term credit is based purely on personal security and when once the mortgage of material security or assets is tolerated for securing long-term loans, the personal element would be lost or sacrificed to the mortgaged property or security.⁵ Under a distinct land-mortgage credit based on co-operative lines such principles would not be forgotten and the moral value of the co-operative movement not be lost.

An examination of the latest annual reports of the Co-operative movement in the different presidencies reveals the progress of the movement in the field of credit as well as non-credit activity. So far as credit activity is concerned the system of voluntary deposits and savings deposits has been working satisfactorily in Bombay. The use of Home

⁴ See the recent Report of the Calvert Committee on Co-operation in Burma. It advocates entire separation of the two features of credit, *viz.*, long-term and short-term credit.

⁵ Mortgage credit cannot be easily dispensed with. The title to land, its freedom from encumbrances, its exact value, its net income, and such other aspects have to be ascertained and this is no easy task. The financial equipment needed to lend on mortgage business can scarcely be possessed by the present-day short-term co-operative banks.

Saves, the attracting of long-term deposits and other kinds of 'savings' deposits are some of the salient features of the co-operative movement of Madras. The entire dependence on fixed deposits forms the peculiarity of the co-operative movement in Bengal. Village societies of unlimited liability with a share basis and dividends have done much to stabilise the financial condition of the co-operative society. A more prompt payment of the loans is being enforced than before.⁶ Delay in the making of loans is also being eliminated. An effort is being made to extend the current of co-operative activity in the direction of non-credit activities of the people and Bengal is once again in the forefront of economic activity and much progress has been recorded in this direction in the field of milk distribution, the prevention of malaria in villages, and the settlement of middle class families on land. Most of the primary societies do not fall under the category of "hopeless." The number of "average" and the "good" or "model" societies is on the increase everywhere while those that are usually classed as "bad" societies are on the decrease. There is, however, room for considerable progress in this direction.

The financing banks of the village co-operative societies known as the Central Banks are tending to provide the needed capital and have often in the past interfered too much with the administrative details of the primary societies. Their anxiety to secure the safe return of their capital literally forced them to divide this authoritative task of inspection with the Government officials, the Union and other bodies of the primary societies. In most cases it has tended to stifle the genius and the true spirit of co-operation and has made the primary units mere branches of the financing banks. The banking unions

⁶ The recent Calvert Committee explains the failure of the Co-operative Credit movement of Burma as due to the unpunctuality in the matter of repayment of loans. The Government had to literally sustain a loss of about 30 lakhs of Rupees for resurrecting the co-operative movement in Burma.

or the supervising unions or the guaranteeing unions⁷ have all been initiated in the different provinces to remove this danger and to run the primary societies on proper lines.

The Central Banks besides providing the capital tend to act as the balancing mechanism of the funds of the primary societies. Highly valuable as the ceaseless training ground⁸ for the village societies' directors in the field of finance they are destined to play an important part in fusing an organic touch between the primary societies and the wider money market of the country. In addition to this they can initiate new lines of co-operative activity on behalf of the member societies, supervise and control their activities by their eternal vigilance although the Government auditing and inspecting staff or the honorary workers of the supervising Federation are supposed to be doing the same. Provided with more fluid resources the Central Banks can easily finance the short-term requirements of the primary societies.⁹

To complete the financial machinery the Apex Provincial Co-operative Bank has been created to act for the Central Banks much in the same way as the Central Banks do for the primary societies. But a close nexus has not been established

⁷ The recent Calvert Committee recognises the danger of regulating the supervision of the primary credit societies. The credit trustworthiness of the members cannot be properly guaranteed by the Guaranteed Unions. As they have never supervised the primary societies it has recommended their entire abolition. The inspecting staff, when properly trained, should inspect and act as sympathetic guides and teachers to the societies. The Punjab model is upheld as worthy of imitation.

⁸ It can be stated that businesslike dealings exist here alone. The paid secretaries, the careful manner of handling cash resources, the exacting of securities from officers handling the banks' cash are instances of wise and efficient management and the primary society can learn this aspect much to its advantage.

⁹ Dependence on the overdrafts of the Imperial Bank of India for the formation of the fluid resources is bad and ought not to be freely indulged in. This feature has to be removed at the earliest stage. It is not financial prudence to count on the unstable funds as part of their fluid resources. The present practice of counting upon the Imperial Bank for supplying 75 per cent. of the fluid resources is bad. Its overdraft ought not to be higher than 25 per cent. of the total fluid resources.

as yet between the organised provincial co-operative finance and the short-term money market. High money rates might be prevailing in the short-term money market, but the surplus deposits of the financially strong Provincial Apex Co-operative Bank even, are not transferred to mitigate the tightness. Investing in Government securities instead of depositing in Commercial Banks¹⁰ or lending the surplus to other Apex P. C. Banks is the present-day feature. If there is paucity of funds it is strengthened by funds secured from Imperial Bank which grants cash credits. The other joint-stock Banks also are now discounting the co-operative paper rather freely.

The starting of a Central Bank of Issue with regional branches would simplify this matter. Co-operative surplus money can be made available to trade and commerce and *vice versa*. Fluidity of capital which is not at present secured by holding excessive Government investments can be secured out of this arrangement. The main duty of the Central Reserve Bank, then, is to link and co-ordinate the co-operative short-term rural finance with the short-term money markets of the different financial centres. The starting of an All-India Co-operative Apex Bank might tend to defeat this laudable endeavour. It might tend to perpetuate the present aloofness of co-operative finance from the general financial machinery of the country or increase another unnecessary link in the chain of the financial intermediaries. An alliance with the outside financial sources is absolutely indispensable for the co-operative movement at its present stage.

¹⁰ In Bengal there is the useful practice of lending these deposits to trade and commerce and investing in Government securities. As the deposits increase at the time when there is monetary stringency in the market they can be placed safely as short-term deposits in the commercial banks. This method of treating superfluous money is better than lending to building societies and other forms of co-operative societies needing long-term loans to finance their activities. The best remedy for surplus co-operative funds is to stimulate agricultural activity by granting liberal loans to district Central Banks and help the process of orderly marketing on the part of the agriculturists.

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Now that the co-operative land mortgage banks have become an accomplished fact the retrograde measure of fusing short-term finance with long-term finance should not be encouraged or recommended as a safe measure by the Indian Central Banking Enquiry Committee. As it is possible that tenants possessing no mortgageable rights in land they cultivate require capital for long-term purposes, the co-operative, land mortgage banks for these can be started on the material securities they might hold, and as these would generally be of limited liability character for the same member cannot hope to be a member of two unlimited co-operative credit societies, the guarantee or security of another member not indebted beyond his means can be taken as the basis for the loan to be granted to the principal borrower from this type of the co-operative land mortgage banks. The co-operative land mortgage banks intended for landlords can indeed be of any use only when these tend to cultivate the land themselves. Even the societies of these owner-cultivators can be materially helped by the initiation of Registration of title to land as in the case of the Torren's title existing in the country of Australia. With a further simplification of the legal formalities involved in the transfer of immovable property the possibility of conducting these land mortgage banks without a hitch can be easily realised. In the early days when the investment habit has not been created the declaration of the land mortgage bonds floated by the federated land mortgage banks¹¹ as a trustee security and perhaps the State guaranteeing of interest and principal would also be of signal advantage. The matter of repayment spread over a long period as 20 to 25 years, and equal instalments being paid along with interest annually, and half or 1 per cent. more for the formation of a Sinking Fund which might be reinvested within the movement, would facilitate the member-borrower's loans from the primary

¹¹ Pamphlets explaining the procedure of securing a loan and the way in which the Apex P. L. Mortgage Bank would work would simplify matters.

society. These would collectively be responsible for the loan amount to the District Central Land Mortgage Bank and this would in turn be responsible to the Provincial Apex Land Mortgage Bank which has to work in co-operation with ¹³ the existing short-term co-operative machinery, the agricultural and the industrial departments of the State.

With an all-round improvement in educational environment and the social surroundings of the village, the success of the movement would be facilitated and just as the short-term co-operative machinery has been initiated, protected, controlled and financed, at least in the early stages, and which still continues in a modified degree to the present-day in some of the provinces, the state-aid has to facilitate this movement, for without the repaying of the present oppressive long-term indebtedness and the securing of further capital for financing the needed long-term improvement on land which can afford to yield their revenue only in dribbles spread over a long period, no lasting benefit can accrue out of the short-term co-operative financing machinery alone. If the much-talked-of routing of the *mahajan* or *sowcar* is to be an accomplished fact, both these societies should pool their resources, activities, organising capacities and solve the indebtedness problem of the ryot.

If the non-official bodies existing for propaganda work, consolidation business and extension of the current of co-operative activity into other lines are working in conjunction with the official machinery whose business is to cautiously relax its grip in proportion to the real activity, enthusiasm

¹³ This would help the easy flow of funds from the short-term to the long-term credit institutions as the exigencies of the situation demand such transfer. Again it would enable the L. M. Bank to know the uses to which the borrowed money has been put to. It would be preferable for the L. M. Bank to make the disbursement itself on behalf of the borrower instead of lending the sum to the borrower direct. This would ensure the right use of credit and the main object of the co-operative movement is to see that the borrowed money is put to the right use.

and encouragement of the non-official workers, the success of the movement is certain, and rural regeneration would become an accomplished fact only then.

Lesser officialism, more competent non-officialism, more propaganda work, more activity in the non-credit sides of co-operative agricultural activities, more permanent capital attracted as deposits, spread of higher banking knowledge imparting financial skill, and the necessity for prompt repayment, the formation of a greater reserve fund, lesser display of the profit-hunting tendency to secure dividends and commercialised co-operation, greater real honesty, and more sincere earnestness would enable these people to tackle the many-sided problems facing them in actual life.

This is how the Hadaspur Co-operative Credit Society has been able to metamorphose village life within a short period of twenty years. The success of the society is undoubtedly due to the realisation of the cardinal fact that adequate and prompt finance would be useless without proper and productive use of the same under direct supervision, intelligent initiative, and prolonged guidance of sympathetic and trained non-officials or honorary organisers, who realise and possess high sense of civic conscience. The popularising of the credit instruments such as cheques and bills would solve the currency problem to a great extent.

To-day, India is a country of small farmers, often illiterate, self-contained routine men with almost a proverbial feeling of jealousy towards one another (a characteristic failing of the agriculturists all the world over). A policy of co-operation amongst such men is particularly difficult to achieve. But time and education alone would prove their saviours and regulate their pace and activity in the right directions so that the future citizens of India might be born, bred and brought up in co-operative institutions alone.

APPENDIX VI.

THE FUTURE OUTLOOK OF THE INDIAN JOINT-STOCK BANKS.*

I

The future can be built on the present which is but the result of the past. Considering the present position of the Indian Joint-Stock Banks¹ any serious study would disclose that the following are their predominant features. Lower dividends than in the immediate past or fairly even rates of dividends as in the past, decreasing working capital when understood in correlation with the increased price-level, lack of confidence on the part of the public, sheer inability to secure any prompt financial aid and over-investment in the gilt-edged securities due to lack of a fluid market for short-term investments are some of the salient features of the present-day Indian Joint-Stock Banks. The pathological point of view has strong fascination for me. As in Mathew Arnold's famous lines, I wish I were able to diagnose the evils of the banking system.

He took the suffering human race,
 He read each wound, each weakness clear
 And struck his finger on the place
 And said, "Thou ailest here and there."

But the inadequacy of statistical material precludes anyone from playing the part of a banking pathologist. Its being scattered or diffused in more places than one irritates any worker in the field. The Statistical Tables relating to the Banks, the Report of the Registrar of the Joint-Stock Companies, the Report of the working of the Co-operative

* This was part of the written evidence submitted to the C. B. Enquiry Committee. It was first published in the *Calcutta Review*, May, 1930.

¹ There are 133 Indian Joint-Stock Banks with about 421 branches in all. *Vide* Statistical Tables relating to Banks in India, 1928.

movement, the Trade Journal and the weekly information issued by the Controller of Currency would have to be ransacked for what little that can be gained by these enigmatic reports. The Imperial Bank always follows the policy of, "never explain, never regret, and never apologise" and no Annual Report portraying the financial state of the country is issued. There is no Banker's Journal displaying the combined figures of their working. In the absence of such information one has to literally grope in the dark to feel his way in the matter of our banking operations and their significance on the different aspects of our economic life. The method of analysis cannot therefore be applied, for details of Bank organisation, methods and practices are shrouded in mystery.

In spite of the nominally increasing growth of the working capital of the Indian Joint-Stock Banks as denoted by the Statistical Tables^a relating to Banks in India their present position is really deplorable. Compared with the contemporary foreign banking institutions their record is indeed a

^a The following tables illustrate my remark—

TABLE I.
(In Crores of Rupees)

Year	1913	1918	1923	1924	1925	1926
Capital and Reserve ..	4	7	11	12	12	12
Deposits	24	42	48	55	58	63
Total	28	49	59	67	70	75

(See the Statistical Tables relating to Banks in India.)

If these figures are correlated with the present price-level we do not find an increase in the capital. Unless this is done we would become the victims of "money illusion" as Prof. Fisher would put it.

Year	1913	1918	1923	1924	1925
General Index of price level ..	100	157	157	158	159
Working Capital (in crores of Rs.) ..	24	49	59	67	70
Working Capital correlated to pre-war level of prices ..	24	31	38	42	38

The above tables do not take into account the smaller banks and loan companies which are conducting banking business to a large extent. The resources of the indigenous bankers are also excluded.

depressing one. As adequate banking statistics which cover the entire field are conspicuous by their absence I refrain from making any appeal to any statistical device to show how our system is progressing when compared with others. The stationary and sometimes declining dividends speak eloquently of the struggles of the Indian Joint-Stock Banks. Their low cash reserve as against their demand obligations fails to inspire the necessary confidence in the minds of the depositors.* Unorganised, unaided and subject to the malicious propaganda or barbed darts and vile credit-wrecking tactics of their enemies, the Indian Joint-Stock Banks are "muddling through somehow". If timely action is not taken the unfailing and inexorable law of the survival of the fittest would soon eliminate quite a large number of these tottering institutions.

With no banking legislation, no official supervision, no fluid market for short-time investments which consequently leads to an over-investment in gilt-edged securities, no co-ordinated policy of the different joint banks, no centralised banking in the way of the rate of interest and no check against the frequent happening of swindles by directors or officers of banks the Indian Joint-Stock Banks have been unable to show remarkable progress. Though some of the Indian Joint-Stock Banks are not incapable of holding large monetary resources yet the logical consequences of the above circumstances are bank failures now and then. Now that re-organisation and radical reform of banking are under contemplation the broad lines of reform may be indicated briefly. A unified banking system with an independent Central Bank of Issue acting as a regulatory authority in a carefully developed discount market and creating elastic currency to satisfy the needs of business must be the sole objective of our banking reform. A complete rationalisation of our banking

* Since the sale of Government securities in the market in 1917 there has been a drop in their value.

system is needed at the present hour. It alone would tend to promote specialisation in credit business and without an efficient use of credit, agriculture, commerce and industry cannot be established with any degree of success. It is to the banker, the chemist, the physicist, and the engineer that India has to look to recreate her economic conditions and lead to a fuller utilisation of her small dormant hoards of precious metals and a better working out of the industrial opportunities thereby increasing the total wealth of the country and the prosperity of the people.

Now that a Banking Committee is examining the credit organisation of our country the position that these Indian Joint-Stock Banks would have to occupy in a well-built and thoroughly organised system has to be studied with care, insight and sympathy. It would not be far wrong to say that the Indian Joint-Stock Banks lacking the fostering guidance of a true Central Bank of Issue have been functioning in a credit organisation whose growth has been aptly compared to that of a wild jungle. The lack of positive information and detailed statistical knowledge precludes one from making any judgment as regards the safety and solidity of our Joint-Stock Banks. Although it is an accepted fact that the dividends of some of the established banks are somewhat fairly higher than returns from trading or other joint-stock companies, still the fact that more capital is not being invested in the expansion of the existing banks or the establishment of new big joint-stock banks speaks for itself. The qualitative aspect of Indian Joint-Stock Banking is far from convincing and the quantitative aspect is equally disappointing.⁴

II

What are the real causes leading to this unfortunate position? Some of the causes stated by the managers of the

⁴ 339 towns out of 2300 have banks or branches or agency of a bank. There is no reason why the other towns should not be equipped with banking agencies at least.

Joint-Stock Banks are analysed and a critical scrutiny and analysis of their statement leads to certain important conclusions as regards the planning of their immediate future.

OVER-INVESTMENT.

Like the Imperial Bank the majority of the Indian Joint-Stock Banks hold large blocks of Government securities.⁵ Even these cannot be turned into ready cash. There are no open market operations on the part of the Imperial Bank to steady their price or defeat the bearish factors and tactics of the operators on the stock market. Without reasonably stable or steady value attached to the Government securities, the banks are finding it difficult to maintain steady dividends. Secondly, as the deposit rate they pay is high the interest secured from their investments does not generally give a broad margin over the deposit rate which they agree to pay. Broadly speaking, banking profits depend on the difference at which they lend over the rate which they pay for their borrowings from the public. Thirdly, the Indian Joint-Stock Banks are therefore forgetting their social mission which is to aid commerce and industry.

It is indeed true that the holding of Government securities or trustee securities ought, generally speaking, to be considered as a healthy sign indicating the true financial strength of the Joint-Stock Banks. But unfortunately owing to the above set of circumstances described already the investment policy has been causing them grave anxiety. Again no commercial bank ought to congratulate itself on its possessing a higher amount of investments over and above their actual paid-up capital. It is bound to create grave trouble whenever it wishes to expand its business or open branches in the interior. Although full regard to liquidity has to be paid still this over-investment even in gilt-edged securities has to be given up. The English Banks persistently sold their surplus percentage

⁵ See C. B. Enquiry Committee Report, p. 385. "A large proportion of resources is locked up in gilt-edged securities as compared with bills."

of war-time investments immediately after the war. From £398.6 millions in 1919, they came down to a low level of £290.5 mil. in 1927. The sum realised was utilised as advances to commercial borrowers.⁶ Such a policy of pronounced reduction in the matter of their investment would undoubtedly improve the situation. Even the Presidency Bank of Bombay suffered in a like manner on account of its excessive holding of the E. I. Company's paper. Firstly it proposed to open a branch in Calcutta in 1841.⁷ As this was not allowed, it suggested the undertaking of foreign exchange business so as to find work for its huge capital. Considering the possibility of the Hon'ble the Court of Directors refusing this measure it placed the alternative of reducing its capital exactly to one-half and that the note-issue should similarly be cut down to one crore of rupees alone.⁸ The Court of Directors refused to permit any of the measures and until there was the cotton boom in 1860 there was not properly speaking any legitimate trade demand absorbing its huge paid-up capital which had to be locked up in the Company's paper alone which paid four to five per cent. rate of interest.⁹

COMPETITION.

Taking leave of the discussion of excessive investment we must turn to the second reason which is repeated by the

⁶ See J. Sykes, *The Present Position of the English Joint-Stock Banks*, p. 68.

⁷ See my book "*Organised Banking in the Days of John Company*", pp. 487 to 494.

⁸ See the Report of the Directors of the Bank of Bombay submitted at a Special meeting of the Proprietors held on Thursday, the 2nd day of September, 1852, 11 o'clock in the forenoon. These requests were not sanctioned by the Hon'ble the Court of Directors. See their Financial Letter to the Government of Bombay, Letter No. 1, of 1853, dated 19th January 1853. Paras. 3 and 4 of this letter explain the reasons for their refusing to sanction this request.

⁹ See Resolution No. 19, Financial Letter from the Court of Directors to the Bombay Government, dated 26th July, 1843.

managers of the Indian Joint-Stock Banks. Since the late Mr. A. Bowie raised the cry of "uneconomic competition" on the part of the Imperial Bank it has become fashionable in season and out of season to repeat the bogey of competition. If it were not the Imperial Bank of India, the Government of India and the existing Provincial Co-operative Banks and the District Central Co-operative Banks and the Exchange Banks are looked upon as rivals tending to spirit away deposits which would naturally have flowed into their hands in the absence of any of these competing rivals.^a

Much reliance cannot be placed on the supposed cut-throat or uneconomic competition on the part of the Imperial Bank of India. It is the acknowledged policy of the Imperial Bank to consolidate its present position at the existing two hundred branches and not to open more branches in the meanwhile. Competition with the indigenous joint-stock banks is always deprecated so long as the latter are charging moderate rates of interest. It is the declared policy of the Imperial Bank to open a branch only where scope exists for two Banks. Even though a branch of Joint-Stock Bank might exist, the Imperial Bank would open a branch so as to extend banking facilities to the people of the locality. So long as the dangers underlying branch banking are understood and every effort is made to eliminate them, this system of extending branches by the Imperial Bank has to be hailed as a welcome measure. None the less there is a grain of truth lying hidden in these blasphemous remarks of the Joint-Stock Banks. Unable to secure interest-free Government deposits they have raised the cry of State-subsidised competition. The State, however, has to select a strong bank as its depository for the Independent Treasury System has grave evils of its own. The system of nursing weak banks by declaring them as Government depository banks is no less an evil than the

^a See Resolution No. 19, Financial Letter from the Court of Directors to the Bombay Government, dated 26th July, 1843.

one of maintaining an Independent Treasury System of its own.

Although there might be some amount of truth in the above contention, still the grievance that the Co-operative Banks are effective competitors as they tend to attract deposits by offering high interest rates is entirely a mistaken notion. As in modern Germany or France we do not find even our urban or the Provincial Co-operative Apex Banks conducting banking business on similar lines which the commercial banks adopt.¹⁰ In Germany the co-operative banks grant advances on the well-known basis of the cash credit system and discount bills. Even in modern France the situation is the same. The Co-operative Banks created by the State initiative and financed to the extent of 50 mil. francs are acting as the ordinary joint-stock banks for the locality. Such competition hardly exists in any of the money centres of this country. It is true that the co-operative banks offer a high deposit rate. As I have stated elsewhere, they are "complementary" institutions.¹¹ Their sole aim is to play the humble rôle of "collecting banks." They are "feeders" to the Joint-Stock Banks for it is their mission to endow small people with moderate capital and train them to banking habits and prepare them for business with more capitalist institutions to which they are likely to go as they become wealthy. Such being the case there is no reason to take umbrage on account of their successful working. In the near future when trade financing is done by means of bills the trade paper endorsed by the co-operative banks would furnish ample opportunity for the safe investment of their

¹⁰ Even though the Imperial Bank's branch has been closed at Serajgunj and the local Central Co-operative bank has been attempting to fill the void the question of opening current accounts, collecting cheques and bills is not taken up and sanction has to be obtained for this from the Registrar of the Co-operative Societies for these purposes. See Free Press Message the *Liberty* of 12th September 1929. In some places, however, the co-operative banks are opening current accounts, purchasing drafts and selling remittance.

¹¹ See my "Present-Day Banking in India," Chapter on Co-operative Banks.

funds. Greater co-operation would thereby ensue between the Indian Joint-Stock Banks and the other kinds of banking institutions or bankers. Co-ordinated and not competitive banking must be the ideal that ought to govern their operations in the future.

P. O. CASH CERTIFICATES.

The Government of India which has already incurred their displeasure for depositing its funds in the Imperial Bank alone, has once again become a target of criticism. By virtue of increased interest rates which it has agreed to pay to the holders of the P. O. Cash Certificates from the 1st of August, 1929, it is feared that it would tend to divert the flow of deposits from the usual channels to the hands of the Government of India. That the Government would absorb the available savings is the specific grievance which has been set up by them. Even the Exchange Banks consider this effective competition on the part of the Government as one of the reasons for the slow growth of their deposits. The floating of Treasury Bills and the currency contraction in the slack season, though ostensibly pursued with the object of propping up exchange is disliked by the Indian Joint-Stock Banks. The Treasury Bills are being floated at "rates of interest which no bank even of modest means could think of giving its depositors."¹² This has been acting as a double-edged weapon. Firstly, it has tended to restrict the volume of their deposits. Secondly, it has tended to demoralise the tone of the stock market and the Government securities have naturally

¹² If we study the English Banking system the average rate at which Treasury Bills were floated was £4-10s.-3d. hardly higher than the rate at which the commercialists were able to secure the discounting of the bills by the Banks which was £4-9s.-6d. This shows that the British Government in spite of its increased indebtedness did not pay very high rates for its short-term indebtedness. See Sykes, *Ibid.*, p. 91.

suffered depreciation as a result of unexpected shifts in the matter of Treasury Bill sale policy.¹³

EXCHANGE BANKS.

Repeated failures of the Indian Joint-Stock Banks have turned the people more to the Exchange Banks who have already become unpopular for their exclusive monopoly of financing of foreign trade. Their deposits are increasing though they pay no high rate of interest. Being the victims of unorganised banking the Indian people naturally prefer to place trust in the foreign Exchange Banks whose directors at least are to a certain extent free from the taint of swindling bank resources and utilising them for selfish advantages of their own. The Exchange Banks have built up a tradition of trustworthy service and they usually have at their service a continuous succession of honourable and loyal men. They are gathering vitality, as they go becoming not weaker with age but stronger and more trustworthy in marked contrast with the few traitors of our Indian Bank management who have undermined the prestige of the other contemporary Indian Joint-Stock Banks and have contributed a good deal towards their stagnation and decay. The main excellences of the Exchange Banks, namely, skill, trusteeship and scientific method, must be copied by the Indian Joint-Stock Banks. The general faithfulness of the Indian Joint-Stock Banks is not questioned by anybody but they must copy the best features of the Exchange Banks. It is banking education that can create these features. It is not the men in high places of power but also those who are stationed in every rank and level of banking service who must realise their responsibility and be willing to do their best.

¹³ It is a matter of gratification to find that this opinion is fully endorsed by the C. B. Enquiry Committee on p. 405. "The T. Bills have not yet become an integral part of the money market at their proper value".

III

HARD TIMES AND DEPRESSED TRADE.

The prosperity of banks is purely a relative phenomenon mainly depending on the prosperity of its customers. If the depositors and bank customers suffer from a fall in the price of land which they bought at fabulous prices in the boom days of 1921 or if dullness of trade were to prevail in the days of post-war depression, it is bound to tell adversely on the banks also. There is indeed a lot of truth in the above remark. It is only in 1927-1928 that Indian trade and commerce reached their pre-war level. Trade and commerce are feeders to banking and without banking they themselves cannot be fed properly ; they are as much dependent on the banks as the banks are on the traders and merchants.

FAILURES.

Lastly, the incessant and never-ending¹⁴ failures of the Indian Joint-Stock Banks often remind the people of the fact that it is altogether sheer folly to place confidence in such mismanaged institutions as the Joint-Stock Banks generally prove to be as soon as their management changes hands from the original set of people. Without the continuity of experienced management a deposit in a bank cannot be

¹⁴ The following table shows the failures of the Joint-Stock Banks in this decade—(See Statistical Tables relating to Banks in India) :—

Year.	No. of Banks involved.	Paid-up Capital. Rupees.
1918	7	1,46,185
1919	4	4,02,737
1920	3	7,24,717
1921	7	1,25,329
1922	15	3,29,991
1923	20	465,47,325
1924	18	11,33,623
1925	17	18,75,795
1926	14	3,98,145

considered safe. Repeated failures,¹⁵ are shaking the credit fabric of the Joint-Stock Banks. It must be borne in mind that a "system of banks is like a crowded city where a fire breaking out in one house may soon spread to many others and every house has to bear not only its own fire risk but some risks of all the rest". Without a far higher standard of banking prevailing among the Indian Joint-Stock Banks it is impossible to consider the banking structure as a sound and strong one. The present-day Joint-Stock Banks are not regarded as national institutions endowed with the trust of the community.

Having seen a correct representation of the difficulties under which the Indian Joint-Stock Banks are labouring, it is the bounden duty to plan the future of the banking system in such a way as to provide a harmonious atmosphere congenial to their rapid development. What then are the remedies needed to cure their weaknesses? Can the Indian Joint-Stock Banks hope to improve their situation by their own efforts and measures in the direction of setting their houses in order? What can an external agency like the Central Bank of Issue hope to do for them? How far would the legislative and administrative action on the part of the Government and the co-operative action of the depositing public and the borrowing customers be of any use to them? Are there any other tentative measures by which it would be possible to help them at the present juncture? A thorough discussion of these varied factors would be impossible within the scope of this short paper.

But the definite programme of banking reform falls broadly under two headings, *viz.*, internal and external. The

¹⁵ Quite recently the Karachi Bank failed and a desultory acquaintance with the history of Indian Banking would show how the lack of confidence created by bank failures has been a well-marked feature since the second half of the 19th Century.

internal reorganisation has to be brought about by the Indian Joint-Stock Banks. This is more important than the external aid for without the former the external agency would either decline to lend aid, or even, if it were to be rendered, no lasting and permanent improvement can be achieved in the position of the Indian Joint-Stock Banks. An external agency can mend the evils but what is required is a radical cure which can arise out of a proper internal reorganisation.

Of the external remedies the administrative measures of Government, further legislation and a more enlightened public debt policy are given proper attention. The co-operation on the part of the depositing public and the borrowing customers and close co-operation amongst the bankers themselves would go a long way in improving the situation. But the creation of a Central Bank of issue is the proper remedy for many of the present-day defects.

Taking the internal remedy first into consideration the Indian Joint-Stock Banks would have to sacrifice or give up the unnecessarily large holding of Government securities.¹⁶

¹⁶ Broadly speaking the banking policy in the matter of investments is to select liquid and easily realisable securities possessing steady value and a wide market. As gilt-edged securities possess these features the bulk of bank investments consists of Government securities. But these do not form the only item in the matter of investments. If the Bank conducts issuing business the shares of new companies floated by it are generally held by it till the time the investing public digest these shares. Similarly a city bank seeking to extend its operations in the most safe and economical manner tends to acquire shares in the banking companies of the interior and hopes to influence its policy and seek an outlet for its surplus funds. The shares of a foreign banking company might be required so as to affiliate it to itself. This might not be done with the express purpose of conducting foreign banking on any large scale but merely to render more efficient service to its own customers in the direction of financing foreign trade. Indian banks do not generally possess such a wide range of securities and shares of few stable industrial companies form the major constituents of the investment items of the Indian Joint-Stock Banks. The acquisition of interests in other banks domestic or foreign is not yet a marked feature of any one of the important Indian Joint-Stock Banks. The daring yet fruitful policy of the Lloyd's Bank or the Barclay's Bank in this direction finds no counterpart in the Indian Joint-Stock Banking System. Too large a part of their investible surplus finds its way into gilt-edged securities. This has to be rectified.

In their endeavour to incline towards safety they are leaning too much on this support. Sound commercial advances marshalled in a steady succession of maturities are more lucrative than gilt-edged securities. Banks must invest wisely and not speculatively. True wisdom in the matter of bank investment consists in avoiding "frozen assets". The problem of finding adequate business for the released funds would have to be faced. Indirect financing of agricultural interests through approved indigenous bankers or the financing of the small artisans or traders purely on the personal knowledge of the indigenous bankers can provide the needed avenues and unless they care to cultivate more regular business dealings with the indigenous bankers the mere financing of trade and industry in the big centres would not absorb all their liquid resources. The banking net must be spread wider so as to cover a greater area than at present. It is the financial life of the big cities alone that they are able to influence at present. They must descend to rural tracts and hope to influence the lives of the masses in a significant manner. The real problem of Indian Banking is to secure to the Indian Joint-Stock Banks power so as to enable them to control the indigenous bankers and they should themselves be controlled in their turn by the Central Bank of Issue. This is the unity and organic relationship that ought to pervade our banking structure. The present-day loose and unorganised system has to be displaced by a more concentrated and highly integrated banking system.

Secondly as one reputed Professor of Economics stated, "a banker ought to be two-fifths gentleman, one-fifth economist, one-fifth lawyer and one-fifth accountant". Unfortunately the lack of such high qualities renders possible mismanagement of banks. A weak, loose and inefficient audit unable to influence the bankers usually tolerates such inconsistencies, till the day of final reckoning comes when some important incident leads the depositors or lenders of

money to doubt of the standing of the bank and the attempt on their part to collect the deposits brings to an end the existence of the tottering bank.

An efficient and expeditious service and the expanding of general agency business done by them is sure to bring in greater deposits and more constituents. Banks have to go to the people and not wait for the people to come to them. If sufficient employment for these funds is secured the financial strength of the Indian Joint-Stock Banks is bound to increase. No time should be lost in attempting to reform and reorganise the internal framework on a sound basis. It is not for the sake of mere self-interest that this reorganisation has to be undertaken by the volition and prescience of bankers themselves. Unless this is carried out immediately the mere setting up of any external agencies would not solve the riddle and even these external agencies would consider these Indian Joint-Stock Banks a constant source of anxiety. The help that any external agency would render can bear fruit only under improved management of the Indian Joint-Stock Banks. In the absence of any such reorganisation it would tend to postpone the evil day. It is foul financial weather that is the real test of sound banking and I venture to think that without real improvement in the internal management of the banks their position would become strained, if another crisis of the nature of 1913-1915 period were to happen.

EXTERNAL REMEDIES.

A more enlightened policy on the part of the Government with reference to Rupee loans and the Treasury bills is needed and everything depends on this important reform. It is absolutely imperative that no further suspicion should be roused that the Government is bent on floating further Rupee loans in the Indian money market. The slackened response to the last Rupee loan means after all that it is high time to consider the advisability of proceeding slowly in the matter

of capital expenditure on the part of the Government even for productive undertakings. The present market value of gilt-edged securities should not be tossed about hither and thither as a result of the vacillating public loan policy. Further depreciation of the value of Government securities means further cuts in the profits of the Indian Joint-Stock Banks and the dividends they declare. Lower dividends mean lower deposits. The lower the working capital the lower would be the profits unless it is offset by greater turnover of the capital resources. This is the vicious circle that is being induced by the present-day public loan policy.

ADMINISTRATIVE MEASURES.

Several critics have pointed out the necessity of pursuing a strictly scientific policy in the sale of the Treasury bills. The resort to the Treasury bills as a deflationary measure in order to support the sterling value of the rupee in the slack season is undoubtedly tending to the reduction of deposits available to the Banks. Firm money conditions induced by their sale may succeed in bringing about an improvement in the rate of exchange and maintain it at a safe level. The high rates paid for them as well as the long term loans would mean in the long run greater inroads on the taxpayer's purse.¹⁷

¹⁷ It is not germane to this topic to discuss the economic effects of public debts. The floating debt even though it might consist of Treasury bills has its effect on the Bankers. Apart from financial danger to the State, the inconvenience to trade and commerce is no less grave. The possibility of habitual renewals tends to make it permanent. This acts as a detriment to banks for their deposits would be cut down and the discount rate would rise. Prices of goods rise and the standard of living tends to become very high. The Banks might hold these safe Government promises and refuse to take risks involved in commercial loans and discounts. It is liable to provoke inflation. Lastly it might lead to grave consequences if renewals of Treasury bills are slackened. Foreign holders of these lose confidence in these certificates and national money and this loss of confidence affects adversely the national rate of exchange.

For a more complete discussion see the "Revue de Science et de Legislation Financieres", January-March Number, 1925, pp. 100-102.

See also H. E. Fisk, "French Public Finance in the German War and To-day," pp. 15-17. See also H. C. Adams, "Science of Finance," p. 526.

This unnecessary increase of tax-burden when the taxable capacity is so very low has to be borne in mind. It would have an adverse effect on the purchasing power of the people and trade would not recover rapidly as a result of this deflationary policy which of course is due to their anxiety to keep the exchange rate above *ls. 5½d.* the gold export point from this country. So long as the sterling resources are few there can be no sale of gold exchange or gold at this export point in spite of the Act IV of 1927, Clause V. This perhaps is the reason for the anxiety of the Government not to allow exchange to fall to the low level of the gold export point from the country.

LEGISLATIVE MEASURE.

Another direction by means of which the Government can hope to protect the directors as well as the public lies in passing helpful and suggestive legislation. Government guarantee of deposits or the formation of a "Safety fund" are bound to be mere palliatives and do positive harm to the conservative banks. The possibility of few depositors being selected as bank directors is a remedy which can only be permitted by a change in the existing legislation with reference to the Joint-Stock Banking Companies. Those taxes which are interfering with the development of banking amalgamations should be removed. A readjustment of the other taxes on a lower level than at present would act as a further impetus in the starting of more banks and in view of the fact that the indigenous bankers are to develop into modern banks this recommendation has to be virtually carried out. The possibility of selecting a few other banks "as public depositaries"¹⁸ after exacting due security would have its own efficacy at the present juncture when even the established

¹⁸ See the U.S.A. where there are a large number of banks—7,224 acting as public depositaries. See the annual Report of the Treasurer, 1926, p. 604. "One Bank in every four is a Government depositary."

Indian Joint-Stock Banks are not able to create the needed confidence. It is indeed true that the false tongue of rumour cannot be controlled in any effective manner. Its vivid conjectures can be silenced only by publication of relevant facts indicating the general financial strength of the Banks. The financial intelligence of the reading public can after all be a more effective safeguard than any legislative enactment.

CO-OPERATIVE EFFORTS.

The depositing public and the shareholders would have to co-operate with the bank management in every way. If the depositors are taken into confidence by the managing board there is no reason why they ought to get shy of the Indian Joint-Stock Banks. Advisory committees of depositors and influential traders to help the branch managers in the matter of investment of bank's funds would be very helpful.

Sometimes the frauds and malpractices which the Banks have experienced from time to time have led to stricter regulation and restriction of credit by the banks with the result that *bona fide* constituents suffer as a result of this vigilant attitude. This attitude should not be mistaken by the *bona fide* constituents.

THE CENTRAL BANK OF ISSUE.

The starting of a Central Bank of Issue would indeed improve their situation in several ways. Besides providing rediscounting facilities and thereby enabling them to convert their assets easily into liquid cash, a Central Bank is bound to confer inestimable advantages on them in the following directions. A careful scrutiny by the Central Bank, which would be made at the time of rediscounting the eligible commercial paper would automatically raise the standard of banking. The very example of its conservative management would act as

an elixir or life-giving tonic to the almost stagnant Indian Joint-Stock Banks of the present day. If the constitutional position of the Central Bank¹⁹ is so devised that it precludes competition with the commercial banks this by itself would afford an impetus to the Joint-Stock Banks to extend into the interior in their endeavour to secure fresh business. But the starting of a Central Bank would indeed take time. In the interregnum, the Imperial Bank can render some good to the Indian Joint-Stock Banks by hoping to act as a Banker's Bank. There is infinite possibility in this direction and all credit institutions can be granted liberal advances at one per cent. or $1\frac{1}{2}$ per cent. below bank rate on the security of gilt-edged stocks or investments so long as they fail to convert them into liquid resources. It is not by merely lowering the bank rate that the lending policy can be liberalised or made elastic. Less harsh restrictions than are prevailing at present would mean helpful overdrafts to the Indian Joint-Stock Banks and a part of the interest-free national balances secured by the Imperial Bank can be utilised in this manner. This is not entirely a new and dangerous innovation for it is a definite policy of the Imperial Bank to grant accommodation in this manner to business houses and industries. Timely help and succour and not mere spoon-feeding should be the object of this liberalised lending policy. Mere facilitating of internal transfer of funds or remittances at low rates is not by itself a very great help to the Indian Joint-Stock Bank. The starting of more clearing houses is another estimable service for which the Joint-Stock Banks ought to feel grateful to the Imperial Bank. Something further is needed in the direction of cordial relations between the Indian Joint-Stock Banks and the Imperial Bank. Both of them must realise the

¹⁹ This can be done by confining its business to note-issuing and discounting trade bills of short currency and it would be prohibited from doing ordinary banking business of a commercial bank.

lessons of the past and be aware of the current developments and current thought.²⁰

CONCLUSION.

A clear and consistent action on the part of all the interests concerned is necessary and the co-operation of the different sections would secure to the Indian Joint-Stock Banks a solid ground for their future expansion and economic development of the country. Small Indian Joint Banks or Loan Companies are being started here and there. If the monthly report of the Registrar of the Joint-Stock Companies is examined the activity of the people in this direction can be immediately realised. But in the economic sphere it is not mere quantity but quality that tells. Few sound banks can achieve more lasting good and confer more permanent outstanding benefit on the country than many bogus banks which tend to put back the clock of economic progress. National well-being, price-levels, profits, employment and purchasing power of wages are of essential importance. Their control by a sound banking policy under the capable leadership of a nationally managed Central Bank would secure the welfare and happiness of the teeming millions of this country.

To sum up, this survey reveals much that is defective in the present-day situation of the Indian Joint-Stock Banks. To increase their usefulness, self-improvement, external aid and thorough reorganisation of the entire banking structure

²⁰ Even the English Joint-Stock Banks which are considered as "paragons of conservatism" have changed their policy towards industries. Even in America the banks have followed a liberal lending policy. Extended loans and less rigorous insistence in the matter of repayment are evidently a proof of their sincerity that they do not hold a too detached view towards industries as in the past. This elasticity in the matter of lending has to be noticed. See H. W. Macrosty, "Trade and the Gold Standard"—Paper read at the Royal Statistical Society of London, December 18, 1926—Quoted from the *London Economist*, December 25, 1926, p. 117.

are pointed out as the proper measures which can guard them against further deterioration. All parties should co-operate in this endeavour as it is a problem of national importance. The present Joint-Stock Banking system must be made safe, economical, adequate and efficient at the same time so as to afford maximum utility to all sections of the community. Incidentally it can be remarked that the present-day absence of definite trustworthy information or banking statistics has to be remedied as early as possible and such figures as would furnish real information or artfully unfold the tale of banking progress should be published by the different units of our banking system.

APPENDIX VII

THE FUTURE OF OUR FOREIGN EXCHANGE BANKS*

EARLY BEGINNINGS.

Prior to the starting of the organised exchange banks and the exchange markets, the indigenous bankers looked after the internal and external exchange requirements of the people.¹ The balance of international payments being in favour of the country gold and silver flowed² in freely. Such intricate economic problems as trade adversity fluctuations did not arise on any important scale.

With the advent of the British East India Company and the foreign trading companies of the western nations foreign exchange business began to develop and an insignificant part

* This was part of the written evidence before the C. B. Inquiry Committee. It was also published in the *Calcutta Review*, Nov.-Dec., 1930.

¹ Until 1796-97 the Governments of the Provinces used to enter into contracts with the shroffs or the indigenous bankers for the securing of resources in the different centres. Due to the Accountant-General Mr. T. Myers the practice of the sale of bills and the inviting of open competition was adopted so that this competition tended to secure more favourable rates than before. See the Public Consultations, Fort William, Public Department, Government Manuscript Records, Imperial Record Office, 7th January 1800, No. 47. The Bombay Government adopted this practice so that by selling bills on the General Treasury at Calcutta it could secure the additional revenue needed to meet its requirements.

² Bengal, for instance, not only paid for all its imports but could finance the requirements of other provinces and the China trade at the same time. This led to the drain of specie but gradually it was condoned by a development of the export trade, the founding of banks and a thorough organisation of the currency system. See the Public Department Records—The general Public Letter written in April, 1809 to the Court of Directors so as to convince them of the necessity to grant a charter of incorporation to the Bank of Calcutta. It was only after receiving this charter that the name was changed to the "Bank of Bengal." Up till 1809 the Bank of Calcutta was always referred to as the Government Bank in the index of the Government records.

of it might have been conducted by the Indian concerns and "black merchants" as the Indian people were styled in the records of the East India Company. It was not until the Agency Houses happened to conduct money exchanging, banking and commission business, etc., that there was any advent of the organised banking system into the country. The first large scale moffusil banks were the Union Bank of Calcutta (1829), the Agra and the United Service Bank (1833) and the Bank of Western India (1842) and the Commercial Bank of India (1845). These were unlimited co-partnership banks and their avowed object was, of course, internal remittance and banking business. But as the heirs of the goodwill of the Agency Houses they soon began to acquire foreign exchange business and the prohibition on the part of the Presidency Banks helped them a good deal in this direction.³

ADVENT OF THE FOREIGN EXCHANGE BANKS.

From 1851 the entry of the exchange banks into India becomes noticeable.⁴ More banks would have been started if the East India Company had been more tolerant towards them.⁵ During 1858 to 1862 the Comptoir Escompte de Paris gained entry into this country. Gradually the British, American, German, Dutch, Japanese and the Portuguese banks began to conduct foreign exchange business in this country.

The domestic banking system being insignificant and the few major banks being restricted largely by statutory regulation, these foreign exchange banks, though few, soon acquired

³ At the instance of the Director Cockerell this prohibition was enacted. See any Present-Day Banking in India, 3rd Edition, Appendix III.

⁴ The Oriental Banking Corporation was the first chartered bank of London to gain entry into India.

⁵ See the opposition of the East India Company to the starting of a Bank of India in 1836, the Bank of Asia in 1840 and the Chartered Bank of Asia in 1851. See the Bank of Asia Correspondence issued as a Parliamentary Paper in 1843, Vol. XXXV.

prominence. They secured monopoly over the exchange and remittance functions. So late as in 1875 the Anglo-Indian Exchange Banks were hardly considered as "banking institutions."⁶ Working in an uncongenial atmosphere and subject to the deterrent disabilities of controlling branches stationed thousands of miles away from the head office the administrative capacity of the exchange banks might have had been seriously undermined but for several helpful factors. Their commanding resources, the lack of effective competition on the part of the small Joint-Stock banks at the time of their entry into this country and their implicitly following the unwritten rules of sound banking soon earned for them the respect and confidence of the public and gave them an opportunity to succeed and outdistance the local banks in spite of all benefits which the latter could derive from the patronage of local people and merchants.

By the time the exchange troubles of 1872 to 1892 began to appear the Indian Exchange Banks wisely succeeded in sending back the whole or a large part of their capital to their head office.⁷ At present about 19 such foreign exchange banks exist. All these are foreign-owned banks with their head office outside India. They do not deal with the financing of internal trade or industries *quite on a large scale even in the slack season*⁸ when they find plenty of loanable resources in their hand. They are unhampered by any discriminatory

⁶ See the Evidence of the Deputy Governor of the Bank of England before the Select Committee on the Bank of Issue of 1875.

⁷ See the Evidence of Sir Alfred Dent before the 1898 Committee on Indian Currency, Qn. 1959.

⁸ Mr. Manu Subedar says that it is internal banking that is more important of their work. He does not quote facts and figures in support of his statement and it is a matter of regret that his attempts to secure detailed information failed in every respect. See Annexure I of the Minority Report.

laws as is the case in America or in the foreign countries.⁹ Spreading their operations over a wide area these banks have succeeded in minimising the risks arising from local trade fluctuations. As in Japan where a number of important private Japanese banks exist with extensive foreign departments both at home and abroad we have no such domestic institutions on any important scale. They are conspicuous by their absence. It has been an oft-repeated cry on the part of the nationalist economists that locally directed exchange banks do not exist.

EXCHANGE BROKERS.

Although there are exchange brokers in the important money centres, yet they do not exist in such numbers as in the case of the well-developed exchange markets of London or New York.¹⁰ There are also finance brokers who are sometimes interested in bonds and shares but their exchange business is little. Exchange brokers can be defined as those whose sole business is broking exchange bills and conducting deals in future.

⁹ See Willis and Edwards "Banking and Business," New York, 1925 Edn., p. 28. See also Willis and Steiner, Federal Reserve Banking Practice, New York, 1926 Edn., p. 552. France, Denmark, Turkey, Japan, and Spain have special restrictions imposed on foreign banks but wherever such regulations have prevailed it has become the habitual practice on their part to affiliate themselves with domestic capitalists and start institutions working under local laws. Even England is supposed to have scented dangers in this matter and the Cunliffe Committee recommends an examination of the situation with reference to the "open door policy" maintained by the United Kingdom as regards the entry of foreign banks. But so long as the United Kingdom invests abroad and is anxious to retain the world's financial leadership the London money market must be wide enough to allow operations in diverse currencies and foreign banks must be allowed to conduct their operations. As a guarantee against repudiation the investment of the foreign banks in London would be of some use.

¹⁰ When an Indian Exchange broker dies his place is left vacant so that members might be limited. There is no single Association including European as well as Indian exchange brokers either at Bombay or Calcutta. European banks prefer to have dealings with the *deposit brokers* who deposit Rs. 10,000 as guarantee of ratification of contracts. See p. 429 C. B. Enquiry Committee Report.

AGGREGATE FOREIGN EXCHANGE BILLS.

The aggregate amount of foreign exchange bills¹¹ which can be drawn through the foreign exchange banks can be arranged roughly under—

- (1) Imports and exports.
- (2) Gold and silver.
- (3) Invisible trade.
- (4) Capital movements.

But as no accurate figures can indeed be available under all the above headings specially three and four being purely conjectural it is only a rough idea that can be gained of the actual exchange business transactions. To these must of course be added pure exchange speculations which can only be left to wild conjecture or happy guess. After the recent war this business has increased enormously but it is not yet the usual practice on the part of the Indian merchants to cover all exchange transactions of theirs.

EXCHANGE RATES.

Orthodox foreign exchange theory asks us to analyse the forces of supply and demand for understanding the fluctuations in the exchange rates. The modern exponents of this theory like Cassel, Keynes and others consider the purchasing power parity as the true indicator of the trend of changes in the foreign exchange rates at least in the long run.¹² During the short period speculation, budgetary situation, and capital movements, exercise their influence. Due to the fact that the Government of India pursues a policy of stabilising exchanges the deviations from the artificially

¹¹ See the Memorandum of the League of Nations on International Trade and Balance of Payments, 1913-1927, pp. 143-150.

¹² See Gustav Cassel, *The World's Monetary Problems*, J. M. Keynes, *Tract on Monetary Reform*, p. 88. See Angell, *Theory of International Prices*, pp. 188-90; Nogaro, *The Modern Monetary System*; De Bordes, *The Austrian Crown*, pp. 198-200; U. S. Commission, *Gold and Silver Inquiry Series*, 9 (1925).

established par cannot be very wide nor lasting for a long time. During the slack season the exchange rates would be at the lower level or the gold export point and unless monetary stringency were to act as a buoy exchange practically would be only roughly $\frac{1}{4}d.$ or $\frac{1}{8}d.$ above the gold export point from the country, *viz.*, $1s. 5\frac{1}{4}d.$ Within these limits it is the exchange banks which receive exchange news from the chief important centres of the world that determine the rates every day on the foreign countries. These are published in the local newspapers on the next day. The other Indian Joint-Stock Banks who conceivably conduct foreign exchange on a limited scale for their own customers adjust their rates on the foreign exchange bank rates. Though there is not much brisk activity on the part of the Indian Exchange brokers some amount of arbitraging in exchanges and dealings in futures are entered into on their own account. They are undoubtedly busy making and receiving quotations of rates from merchants and banks and it is not germane to this topic to discuss their activity and bustle at the telephone.¹³ Their anticipations however do contribute something towards levelling the exchange rates.

CHARACTERISTIC FEATURES OF EXCHANGE FLUCTUATIONS.

A scientific study of the exchange rates points out that there are two distinct features, *viz.*, the strengthening of the exchange rate in the busy season and the slackening of the exchange rate in the monsoon season when it is at the lowest level. This general movement is usually smooth and no wide range and spread of fluctuations presents itself. The lack of trade or export bills, the abundance of money in the slack season which is usually in the first half of the official year (April to September) and the floating of the rupee loans

¹³ For a comparison and contrast of the work of our Exchange Brokers with those of the West, see F. T. Rushforth, the Indian Exchange Problem and Phillip's Modern Foreign Exchange.

whose sole proceeds have to be converted into foreign currency to finance capital expenditure on goods explain the low exchange rate of the rupee. This is the period of weak exchange. Expanding trade increases export bills and tight money conditions raise the exchange rate to the gold import point of the country. This is the period of strong exchange. Each successive season these features are reproduced with almost clock-like regularity. Under the Gold Exchange Standard system there was a literal pegging of the exchange rates of the silver rupee and no great deviations or spread of the rates could be noticed in either of the seasons. The releasing of gold or gold exchange from the Gold Standard Reserve at the gold export point from the country and the purchasing of unlimited quantities of sterling or gold exchange whether required for immediate *bona fide* expenditure use of the Government or not when the exchange rate is fast rising, are the present-day methods to curb the exchange fluctuations. Acting as the currency authority the Government have been in a position to have tolerable control over the exchange market. On the whole the system has worked fairly well. At certain times the Government did not resort to the release of gold from the Gold Standard Reserve at the gold export point but have used the "Defence Treasury Bills" to contract currency and steady exchange at $\frac{1}{4}d.$ higher than the gold export point from the country. Similarly gold might not have been permitted to enter the country by unlimited sale or purchase of sterling at a lower rate than the gold import point of the country. According to some measure or other the cherished object of stability of exchange has been realised. The statutory obligation under the Indian Currency Act of 1927 is being fulfilled. Exchange remains pegged at the 1s. 6d. ratio. The Bankers who dislike the treasury bills floated at competitive rates or even higher rates might have noticed a few malpractices. The Government are undoubtedly feeling the strain to maintain exchange a burdensome one but the net result that the ratio has been

observed must be conceded. The *status quo* has always been maintained and there was no serious exchange slump at any time during these two years 1927 April to 1929 April, under the regime of 1s. 6d. ratio.

PRESENT-DAY CHARACTERISTICS OF THE EXCHANGE MARKET.

Throughout this vast continent there is not one important city that can be called the "New York" or "London" of India. The position of either the Clive Street of Calcutta or the wider money market of Bombay cannot be compared with that of the Wall Street in America or that of the Lombard Street in the United Kingdom. Though Bombay has greater share of exchange dealings than either Calcutta or Madras it would be entirely erroneous to minimise the importance of Karachi and Rangoon as important exchange markets.

Compared with the dim early beginning of the exchange markets the first salient characteristic is the close competition that exists in the market. This can be easily discerned by noting "the narrowing" of the exchange points.¹⁴ While

¹⁴ The following quotation from the *Bombay Castle Gazette* explains the exchange operations of the Oriental Bank, the first really strong foreign exchange bank of this country as Benjamin White puts it :

Exchange on London at six months' sight above	£50 at 1s.-10 and 1-4d. per Re.
" " at three " "	£20 at 1s.-9 and 7-8d. "
" " at one " "	£20 at 1s.-9 and 5-8d. "
" " at one day's sight above	£5 at 1s.-9 and 1-2d. "

See the notification of the Oriental Bank in the *Bombay Castle Gazette*, Rampart Row, 12th Sept., 1849.

A comparison of the above with modern exchange rate quotations makes this plain. On Oct. 5th, 1929, exchange rates in Calcutta were as follows :

T.T.	1s.-5½d.
on Demand	1s.-5½d.
Banks buying	
three months' sight bills	1s.-6½d.
four months' sight bills	1s.-6½d.
six months' " "	1s.-6½d.
sight bills	1s.-6d.½
T.T.	1s.-5½d.

formerly the difference used to be ranging from $\frac{1}{2}$ to 1*d.* on a rupee the present-day difference is only $\frac{1}{8}$ *d.* on the average. Difference in exchange might sometimes be as low as $\frac{1}{16}$ *d.* or even worse as compared with the fair difference of the earlier days.¹⁵ Direct rates between Calcutta and the foreign money centres other than London have also been established under the stress of free competition. But such firm connection as exists with London is not to be met with in the case of the foreign monetary centres.

Nextly, many exchange bills D/A and D/P have arisen under the documentary credit principle. With the growth of the volume of trade the exchange market has become wide as well as steady. Banker's clean bills have also arisen to a certain extent. A clean continuing letter of credit is not generally issued to the Indian importer as yet. So far as the time-length of the bills is considered thirty, sixty and ninety days' bills have come into vogue. Sterling bills are predominant and there are not very many rupee bills even in the matter of our trade with the Eastern countries.¹⁶ The lack of an open discount market precludes the early development of the rupee bills and the absence of the latter has been rendering it difficult to create a short term money market where these can be discounted. This is the vicious circle facing the banking reformers at the present day. The habits of the merchants and the

¹⁵ See the Speech of the Chairman of the Chartered Bank of India, annual meeting, March 1928.

¹⁶ Caring solely for profit the Exchange Banks do not allow the import bills to be rediscounted. Though they are drawn for small amounts they can form the nucleus of a discount market in this country. The bulk of the Indian import trade is financed by 60 days' sight D.P. drafts drawn on the Indian importer and the latter has to pay interest usually 6 per cent. from the date of the Bill to the approximate date of the arrival of the proceeds of the bill in London. This rate is raised as soon as the Bank of England rate rises above 5 per cent. If the Exchange Banks were to accept bills instead of purchasing them the benefits of the cheap London discount market could accrue to the importers. But as soon as low interest rates were to continue in the Indian money market the rupee bill can easily become popular. Before the starting of the Central Bank this plan cannot however be realised. See C. B. Enquiry Committee Report, pp. 316-318.

industrialists also must change before the bills of exchange can become more abundant. "Manufactured bills" for emergency currency purposes arise in the busy season and practically disappear when the Imperial Bank realises no such necessity.¹⁷ The market for the exchange bills consists practically of the exchange brokers and the exchange banks. There are not a large number of buyers of hundies in the native bazar even, as in the case of the newly created bill market in the Federal Reserve Banking system.¹⁸ The sole burden of financing exports and imports consequently falls on these foreign exchange banks and the London money market in so far as the latter rediscounts the export bills of the Exchange Banks.

Again there is not much of bank acceptance by the Indian Joint-Stock Banks as in the case of the London Acceptance Credit or the Federal Reserve Banking system of America. Unless an extensive use of bank acceptances is forthcoming and an adequate discount market exists there would be no proper co-ordination between the activities of the two kinds of banks, viz., the exchange and the commercial banks. The absence of rupee bills in the import trade is still a marked feature. If the exchange banks need adequate funds for their operations in India there is at present no means of rediscounting or disposing of their import bills in this country. They fall back on the Imperial Bank and secure advances on securities or rediscount their D/A export bills in London and send their resources to finance their Indian business.

THE IMPERIAL BANK AND THE EXCHANGE BANKS.

The old historical error that the exchange banks financed foreign trade solely with the help of their own capital resources

¹⁷ See A. C. McWatters, Memorandum before the Hilton Young Commission.

¹⁸ See W. R. Burgess, *the Federal Reserve Banks and the Money Market*, Chapter on the Bill Market.

during the years 1860 to 1900 needs no refutation at all.¹⁹ The Imperial Bank of India finances foreign trade only when it helps the exchange banks who might feel reluctant to move funds from London if better money rates were to prevail there or if rapidly fluctuating exchange rates would threaten to involve them in heavy losses if they were to resort to London. If Indian rates are not high enough the same result would happen. The Exchange Banks would secure advances on securities from the Imperial Bank and dependence on the Imperial Bank becomes a marked feature at such times. Thus it indirectly contributes at such times towards the financing of foreign trade. But if the Government were to force the Imperial Bank to raise the bank rate to 8 per cent. as it was done in February, 1929, it might tempt the exchange banks to remove funds to India but much depends on the prospects of the money rates in London and India than anything else. The fluidity of capital depends more on interest rates prevailing at the time than any administrative measures. It would not be far wrong to say that under certain circumstances the Imperial Bank might be forced to finance foreign trade also. It must also be remembered that the Imperial Bank is allowed to conduct foreign exchange business to meet the personal requirements of its customers alone. This amounts on an average to about six crores of rupees.

A CENTRAL BANK OF ISSUE AND ITS CONTROL OVER EXCHANGE.

Now that the long-operating gold exchange standard system has practically removed wide exchange fluctuations altogether, it remains to see how the same desirable feature can be obtained under the Central Bank management of a gold standard. The sole purpose of the gold standard is to achieve

¹⁹ See the Memorial of the Exchange Banks to the Viceroy sent on the 3rd February, 1900, quoted in the Appendix XV, p. 409. Chamberlain Commission, Interim Report, and the Letter of the Government of India sent to the Secretary of State on the 3rd December 1900. *Ibid.*, Appendix XV, p. 407.

stability of foreign exchange. Free gold export shipments and due contraction of credit would restore the exchange rate back to its old moorings. Similarly free gold imports and a liberal credit policy would raise the domestic price-level and check exports with the result that imports would increase and gold would flow back so that the unduly favourable balance of payments would tend to correct itself.²⁰ This is the conception of the automatic gold standard which however is not the standard that has been adopted of late by the important countries. The new gold standard does not solely aim at creating devices for stabilising exchanges alone but it seeks to stabilise the value of gold and thus prevent long-term upward or downward movements in the value of gold or price levels. An effort is thus being made to attain general stability of the world price-level, over short as well as long-term periods. It is not necessary to discuss the further aspects of the new gold standard which is now being uniformly accepted by almost all other countries.

It is apparent then that if the Reserve Bank were to be started in this country this control over the exchange value of the currency can be secured by its policy. With the disappearance of the Government as the "Currency authority" or its dominance over the Central Bank which we have witnessed in the case of the Imperial Bank, the Central Bank has to maintain the exchange level. Operating the new gold standard whose important features would be the absence of a gold currency and international co-operation with the other new gold standard countries, the procedure of parting with actual gold or gold exchange can be resorted to as in the case of

²⁰ See Taussig, *International Trade*, Part 3 (1927). An adverse trade balance is set right by altered exchange rates and this would lead to the building up of a favourable trade balance. This corrective would be efficacious if economic conditions do not change, *viz.*, that the volume of domestic currency is not being inflated, that budgets are being balanced, that speculation does not enter the exchange market, that invisible items do not alter the balance of payments and that no arbitrary restrictions are imposed on the movement of trade and of exchange rates.

the Reichsbank of Germany. It might even adopt the obligation to sell gold or gold exchange only when the gold export point is reached as is the case now with the Nederlandsche Bank to those countries which would permit the free movements of gold. The administrative technique might be different but the principle is always to be the restoring of exchange conditions to stability. Its control over the price-level would be aiming at stability, internal as well as external, *i.e.*, "within as well as without" as Montagu Norman, the Governor of the Bank of England, would put it.²¹

The main problem ahead is not the maintenance of the stable exchange alone, which can however be realised as a part of the Central Bank management of the new gold standard, but our attention should be riveted on the immediate problem of financing foreign trade with domestic resources. Exports and imports have reached the pre-war level only in the year 1927-1928.²² They are bound to expand in the near future. The financing of this huge foreign trade at home is essential. Another part of the duty would be the facilitating of the transfer of the net balance of payments to India proper.

THE DEFECTS OF THE PRESENT-DAY FOREIGN EXCHANGE BANKS.

The chief counts of indictment against the powerful foreign exchange banks as they exist now are that they compete with the Indian Joint-Stock Banks not only in the matter of securing deposits but in financing borrowers in the slack season, that they drain away resources from this country for services which can be performed equally efficiently by progressive domestic banks, that they promote trade in raw materials and the industrialisation of the country is no definite policy of their own, that they refuse to adapt themselves to the requirements of a great agricultural

²¹ See the Evidence before the Hilton Young Commission.

²² See the Review of the Trade of India, 1927-28.

country like India where produce advances are more necessary and should be made freely, that they do not teach the principles of foreign investment banking, that they stoop to unfair tactics against budding rivals, that they are tending to amalgamate with the big London Joint-Stock Banks and future economic development might be served well or ill by these huge financial leviathans, that they do not give us an adequate return for the "open-door policy" we maintain, that they form a compact homogeneous group and give no positive encouragement to the Indian Bank officers to rise to positions of responsibility, that they tend to drain away funds from up-country centres to the ports in the busy season thereby leading to better financial facilities to exporters rather than the cultivators and industrialists, that they have not set up economic standards of bank management and organisation before the Indian Joint-Stock Banks who are financing internal trade requirements and that they will not fit in in a nationally managed banking service which may be planned in the near future to develop our national resources and create productive industry.²³ In short, they refuse to be instruments of national progress. In view of their past opposition to the Central Bank proposals, it is likely that, when the Central Bank would be started they would certainly refuse to co-operate with it.²⁴ Its resolute leadership might be opposed by these banks and Central Bank control might become a mere fantastic dream. Almost a deafening and tumultuous roar of criticism would be levelled against their uncharitable and uninspiring conduct before the Central Banking Committee. No one need be surprised at the particular animus that might be displayed by the critics but the ebullition of national feeling

²³ Another count of indictment is that they do not give satisfactory references to overseas merchants regarding their Indian customers. The Exchange Banks compel the merchant borrowers to insure with foreign Insurance Companies in preference to strong and well-managed Indian ones.

²⁴ See the Evidence of C. Nicoll before Hilton Young Commission, 9N-14148, Vol. V.

is such that many unjust accusations would be levelled and little foibles would be magnified into serious mistakes.

The above formidable list of their shortcomings and defects does not mean that they are not of any use to this country. As models of sound finance the Indian banking institutions can of course learn something from them. The Indian depositors would also have to be grateful to them and every failure of an Indian Bank has indirectly added to their prestige and deposit-attracting capacity. Their skill, freedom from dishonest manipulation of bank funds for Director's pet schemes and the maintenance of liquidity of their resources are indeed objects which ought to be the subject of proper emulation on the part of the Indian Joint-Stock Banks. These have contributed much to raise the level of their steady profits which the Exchange Banks declare at present.

In view of the fact that the World Economic Conference²⁵ has passed resolutions to the effect that "no discriminatory legislation" against foreigners should be passed and in view of the powerful influence the exchange bankers wield in the London financial circles it would be impossible to enact any punitive or provocative taxation measures against them so long as they confine their activities to international commerce alone. Similar well-drafted laws which can be applied to our domestic banks can be imposed on them. A slight return for the trading privileges can be secured. The systematic training of Indian apprentices in the art of banking can be secured out of these refractory exchange banks. But if any further penal measures are to be thought of, such as increased taxation or the withdrawing of the right to attract deposits or the right to open branches in the interior of the country they can easily evade them by registering themselves with Rupee capital as local

²⁵ See the Report of the World Economic Conference, published by the League of Nations, Vol. II, p. 42.

See also the Proceedings of the International Conference on the Treatment of Foreigners, held in Paris in 1929.

banks. Such has been the case in Spain.²⁶ As the Indian field is wide enough to permit the successful working of a number of banking institutions they would not lose this opportunity to defeat the real intentions of any penal legislation that can be enacted. But as I have stated elsewhere if these local banks are forced to maintain an up-to-date register of shareholders²⁷ there would be no possibility to escape this legislation. For the purposes of this act it can be enacted that all banking companies whose shareholders' list has more than two-thirds of its members from outside the country should be considered as foreign banking companies.

Without a real change of heart it would be difficult to make them realise our requirements. Our appeal to them to act as indispensable adjuncts to a nation-wide banking system would be vain. The real remedy then is to proceed cautiously and though our policy should be based on the justifiable motive of destroying all vested interests, the retention of these banks as useful complements in our banking organisation is the only wise alternative that is left to us. In the beginning, we will have to supplement their services and it is only after a time that we can hope to counteract their influence. Our local exchange Banks must be helped by the Central Bank to realise this aspiration. As in Japan, we should retain them in the banking system as willing helpmates, useful brethren, and subsidiary instruments. They must become a cog in the banking wheel. Their present-day uncontrollable and unassimilable part in the banking system and their acting as the chief controllers of our economic progress must be remedied.

²⁶ See the Chairman's Speech, Westminster Bank's Annual Meeting, 1923. See Sykes, *The Present Position of English Joint-Stock Banking*, p. 28.

²⁷ The newly enacted Company Law of 1929 of the United Kingdom contains this provision. A penalty is also imposed if the index to the register of the shareholders is not kept up to date. See sections mentioned in Part IV of the New Companies Act of 1929.

THE FINANCING OF OUR FOREIGN TRADE WITH DOMESTIC RESOURCES.

It has already been pointed out how under certain circumstances the Imperial Bank's funds might be utilised by the Exchange banks to finance our export trade. The lack of co-ordination between internal and foreign trade financing breaks down under these circumstances. If the Central Bank or the Reserve Bank were to lend its exchange funds at low rates of interest after taking proper security from the domestic exchange banks the financing of foreign trade with home funds can be accomplished. Under certain circumstances such as abnormal exports these resources might be reduced or tightened. But a Syndicate of bankers can then be formed to ease the situation, if the Bank of England refuses to help the Central Bank by rediscounting its bill assets in London. A Syndicate of bankers specially formed for the purpose can be utilised in financing the export bills. It might so happen that the local exchange banks might become saddled with huge London credits arising out of the purchase of export bills, i.e., too many London credits than are necessary might be created. The Central Bank can however, purchase these exchange funds by issuing an equal amount of notes at home, if such an abnormally one-sided export trade were to lead to the piling up of exchange funds abroad. This is how general trade prosperity fluctuations can be financed by the help of the Central Bank's resources.

In the case of general trade adversity fluctuations when India has to pay the foreign countries the Central Bank can mobilise the foreign investments held by the Indian people. These can be sold abroad while it pays the Indian owners of the same in rupees. It can float temporary loans abroad to have exchange funds for the purpose of meeting drafts on the same at the gold export point from this country. The undue slump of the exchange can be rectified by this method if especially the price movement tends to be relatively stable

or constant. There would be no very great alterations from the purchasing power parity unless the exchange dealers lose all confidence in the early revival of trade. As these tend to watch the draining away of the exchange funds kept abroad by the Central Bank their gloom tends to increase. These speculative fluctuations might complicate the situation and retard the process of recovery, but their bias would soon become corrected if trade follows the normal course and gives rise to the net balance of payments as in normal years.

The seasonal exchange fluctuations due to seasonal variations confine themselves to the range of a few points. The Central Bank can easily continue the pegging of exchange between the specie points by selling gold or foreign exchange at the gold export point and check the rise in exchange above the gold import point by mobilising gold or gold exchange in its vaults and introducing notes against the same at the gold import point. Mere gold movements would correct the situation. The Ricardian theory of outflow and inflow of gold would preserve the exchange level intact within the gold specie points. A programme of comparative stabilisation of internal prices by the Central Bank would tend to stabilise exchanges at the same time and the dual objective of relatively stable prices and tolerably stable exchanges can be secured without any great friction either to business or banking under an intelligent control and management of the new gold standard.

All this presupposes the existence of the Indian Exchange Banks and a Central Bank willing to help them so as to finance India's foreign trade at home with domestic resources. Since the dismal experience of the Tata Industrial Bank it is becoming practically impossible to create strong Indian Joint-Stock Banks for conducting foreign exchange business alone. Proposals have been made that an Indian Exchange Bank would have to be started or the present Imperial Bank can be converted into an Indian Exchange Bank. Considering the

impossibility of raising large capital for banking business at least on this side of India, it would be far better to create an Indian Overseas Bank which would have a part of its capital raised out of the subscriptions of the individual capitalists and the remainder contributed by the present Indian Joint-Stock Banks. It would easily be possible to raise a large amount of capital according to this method for conducting exchange business at a remunerative scale. If the Indian exporters command better prices for their export bills at the hands of the Indian Overseas Bank the business of financing export trade would easily be attracted by it. The Indian Overseas Bank should maintain always in its initial stages rates about one or two points more favourable than those of the foreign exchange banks in this country. If the exporters secure greater resources by selling their export bills to the Indian Overseas Bank than it would be the case when they sell them to the foreign exchange banks they would flock to the standard of the new bank. If the Central Bank were to help it with funds for this purpose at a low rate of interest more export bills can be financed by the Indian Overseas Bank. More rupees should be granted by the Indian Overseas Bank when purchasing the export bills at differential rates. Of course, rate-cutting would ensue and for quite a long period the foreign exchange banks would prove to be effective competitors. Similar should be the treatment shown towards the importers. They should be securing greater return in foreign currency by flocking to the standard of the Indian Overseas Bank than when they resort to the foreign exchange bank. It is only by this way that we can hope to create an institution meant for conducting foreign exchange business with domestic resources. This is the only way of defeating the present monopolistic character of the foreign exchange banks over the exchange situation. This does not mean that the rupee-sterling exchange would not rule the day in the near future. All foreign exchange rates would be resting on the

rupee-sterling rate for, as in the case of most other countries, we pay our indebtedness in London. We hold foreign balances in London and any exchange rate would be depending on the rate of exchange on London and adjusted by a current rate of other country—London Exchange.

ITS ADVANTAGES.

It remains to point out the main advantages of financing our trade entirely with the help of our domestic resources. An unnecessary tribute is being paid to the London Bankers who accept our bills and discount them in the London Money Market. Payment in sterling would be avoided and exchange risks need not be thought of. Though the Gold Exchange standard gives some amount of protection against fluctuations the resulting inconvenience to the Indian exporters in receiving a sterling bill and selling them to Indian Exchange Banks to receive rupees for them can be avoided. The Indian Importer likewise suffers in having to pay a sterling bill drawn against him. Dealings in future can eliminate all exchange risks.

The privacy of a discount market and the keeping of trade information would be achieved under this system.²⁸ The newly arising national pride resents the financing of our trade solely by means of sterling bills.

Free opportunity for a safe and sound employment of short-term liquid resources would be found in the discount market. The unwholesome over-investment of funds by the present-day Indian Joint-Stock Banks in gilt-edged securities can be checked. The immobilising of the bank funds arising out of excessive investment is a grave evil to the existing Indian Joint-Stock Banks for it leads to an unwholesome concentration of funds in one direction which is bad finance.

²⁸ It is on this ground that the United States of America began to encourage the development of bank acceptances and finance its foreign trade with the help of its own resources.

The discounting of internal and external bills drawn in the course of trading would diminish the opportunities in the above direction of over-investment in Government securities.

Nextly, the Central Reserve Bank would be powerless and ineffective to control credit if the discount market does not exist. Under the new banking conditions that would exist if a Central Reserve Bank were to be created, this active participation of the Central Banker would have a beneficial influence on the market. To guide and control the other banks and to regulate interest rates and money conditions the Central Bank must have liquid resources to efficiently discharge its public trust of checking undue credit expansion and easing credit when it is unwisely restricted. The smooth and gradual control over the discount and the money market is possible only if the Central Bank can have these bills marshalled in a steady succession of maturities. As a recent writer says²⁹ bills discounted and bought in the open market offer an ideal current of maturities. Certificates of Government indebtedness are a poor second. Government bonds and treasury notes have no liquidity at all on the basis of early and successive maturities. Their value as instruments of credit control must depend entirely on their ready saleability, a quality which they fortunately have to a high degree. It might indeed be true that the Federal Reserve Banks conduct open market operations with the help of Government securities rather than banker's bills. As the open market operations are undoubtedly beneficial to a certain extent these would have to be pursued by any Central Bank and an organised money market would be essential for the success of its measures. It is admitted even by Mr. J. S. Lawrence that "these open market operations would be very helpful at the time of gold movements, quarter-day adjustments, the attraction and discouragement of international commercial financing and the removal of undesirable items from the bank balance sheets." The larger

²⁹ J. S. Lawrence, "The Stabilisation of Prices," p. 254.

ideals of price control and business stabilisation may not be achieved by this " delicate touch " or lever of the Central Bank. Considering the manifold advantages that would arise by the creation of a discount market and the financing of our foreign trade with the help of domestic funds and realising that both Japan and America have organised similar attempts to remove their dependence on London, our objective should be in this direction. It is indeed true that in both these cases the attempts are not very successful as yet. But they point out unmistakably which way the banking progress lies. A sustained endeavour has to be made by the Indian bankers in this direction. Nothing is so important in the whole field of banking reconstruction as this.

One fundamental feature of this banking reconstruction should aim at diverting the surplus home or domestic funds for the financing of foreign trade and *vice versa*, i.e., surplus foreign funds for financing home trade and industries. The more extensive use of bank acceptances³⁰ and an adequate discount market would facilitate the financing of foreign trade. In financing imports rupee bills ought to be developed. Specialised discount houses ought to conduct this operation. It is foreign interest-bearing bills that predominate in the import trade. No foreign exchange bank furnishes us with a report on this situation and most of the bills are drawn in sterling and are kept till maturity in this country and are not rediscounted in this country.

³⁰ Bill acceptance and discount market can hardly be created so long as business is run on old ways of cash credit ; so long as no business organisations exist for gauging credit and the credit standing of the firms ; so long as specialising acceptance houses are not in existence as in London ; and so long as the Indian Joint-Stock Banks are very conservative and refuse to educate people in the use of bills. These can be remedied only by more education for bankers and businessmen concerning the advantages and disadvantages of bills of exchange and carefully enacted regulations regarding the use of such instruments. The Central Bank itself should buy and sell such bills of exchange in the open market just to popularise these bills as short-term investments.

OTHER ANCILLARY MEASURES.

Nextly, the initiation of a programme which involves thorough-going co-operation between the Central Bank of this country and the Bank of England would be essential. Otherwise the Anglo-Indian Exchange Banks will refuse to obey the penal rates of rediscounting imposed by the Central Bank and resort to the Bank of England or the London Money Market. An independent monetary policy on the part of the Central Bank would never be effective if the powerful foreign exchange banks with their rich shareholders, intelligent direction and financial support from London wish to run counter to the course of action proposed by the Central Bank of Issue of this country.

Finally, the Central Bank of the country should be intelligent enough to understand the drift of monetary conditions in London. If high money rates were to prevail in London the use of the exchange funds on the call market would enable the Central Bank to secure greater return than before and consequently induce it to lower the Indian rates. The Indian Exchange Banks would do it, if the Central Bank does not pursue this method. Thus it has to co-operate with the London money market and the Bank of England. Their mutual policies should not normally create disturbing influences in the different centres. The question of securing adequate funds can be solved easily by allowing the Central Bank of this country to secure access to the London Money Market and rediscount its bills at the Bank of England. It would also facilitate the stabilising of the money market in this country and with lower rates prevailing in this country Indian funds can even be removed to London. That this can be accomplished in due course of time need not be³¹ doubted.

³¹ This was the idea of the late Sir Edward Holden when he advocated a Central Bank for India. See his speech at the Annual General Meeting of the London City and Midland Bank, the 24th January, 1913.

OUR PLAN AHEAD.

Although the chief meritorious characteristic of present day financing of foreign trade lies in our possessing specialising exchange banks which do not usually tie up their resources in long-term investments in industries or agriculture still the main improvement needed is the financing of foreign trade with domestic resources. It should be done by funds raised inside the country. The would-be Central Bank can accomplish much in this direction. Besides securing exchange stability within the specie points its endeavour should be in the direction of helping the Indian Overseas Bank which would have to be created with the co-operative action on the part of the public and the present Indian Joint-Stock Bank. Acting as the central co-ordinator of banking funds it can take up an active part in controlling credit not only by lowering or raising discount rates but by buying and selling exchange bills at the time the exchange rates deviate from the normal points. Financial co-operation between all these agencies would easily enable us to finance our foreign trade. The use of bank acceptances and the development of a discount market have already been pointed out as the other necessary measures to popularise the rupee bills and they can be drawn in our import trade. The use of bills in place of cash credits in the matter of financing the merchant's requirements ought to take place. Regular specialising discount houses would ease the situation greatly. They can buy bills at banks and act as intermediaries between exchange dealers and bankers and between merchants and bankers. If the Indian Joint-Stock Banks give up other entanglements and specialise in foreign exchange business they can easily succeed if they conduct sound exchange banking.

CONCLUSION.

A comparative price-steadying programme, a proper external borrowing policy on the part of the Government,

individuals and *quasi*-public bodies, a carefully framed note-issuing privilege and the extension of loans by the Reserve Bank on commercial paper or bills or notes instead of Government bonds and shares thus restricting the scope for stock exchange speculation, are some of the most important measures which our Central Bank would have to bear in mind. These ancillary reforms are essential if the vital question of financing foreign trade with domestic funds can succeed. With the prosperity of her great exporting industries such as cotton, jute, tea, hides and skins, increasing efficiency of labour, a mercantile marine of her own, which reduces the invisible payments under this heading and the prosperity of Indian people emigrating abroad which would tend to an increase of remittances into the country, the net balance of payments would always be in her favour and this fundamental factor would greatly facilitate the task which the Central Bank would have to take up in right earnest. Facilitating free gold movements in normal times and making provision for meeting extraordinary situations as slumps and general trade prosperity fluctuations, the exchange situation can always be controlled by the Central Bank. Under an enlightened and consciously controlled Central Bank, which carefully manages its foreign portfolio, the present-day Government arrangements for gold exchange funds would disappear. The successful management of the new gold standard by the Central Bank would tackle the situation and eliminate all exchange fluctuations which are very demoralising either to business or finance. The resumption of the new gold standard without exchange-pegging devices will limit the possibilities of exchange speculation at any time. Its liberal help to the Indian Overseas Bank or the Indian Exchange Banks alone can hope to do something in this direction of financing foreign trade with domestic funds. The present-day tendency of maintaining an *Imperium in imperio* would be checked and the Foreign Exchange Banks recognising the different or

changed political situation might resort to the tactful method of offering a portion of their increased capital for subscription in this country so as to placate public opinion, but the stigma attached to the "foreign banks" would always remain and the local people would securely support and favour the local banks. Thus the attempt of the foreign exchange banks would become futile if an intelligent and persistent effort is made by the local banks to finance foreign trade. Entrenched strongly in the favour of the local people those local banks can with the minimum of legislative interference undermine the position of the foreign and Anglo-Indian Exchange Banks. This is the only rational way of providing an effective solution for a potentially inconvenient banking monopoly. The formulation of such a well-conceived plan would be far more advisable than the enacting of futile and mischievous programmes to limit the services of the present-day foreign exchange banks of this country in the direction of financing our growing foreign trade. The cry that the present number of foreign exchange banks is already in excess of legitimate requirements will of course be raised but it ought not to be allowed to side-track our efforts in solving the main problem of this country. Political independence without financial independence is a misnomer and a will-o'-the-wisp. It is like grasping the shadow instead of the real substance.

APPENDIX VIII

THE FUTURE OF THE IMPERIAL BANK OF INDIA*

Unable to appreciably lower the bank rate or stabilize it all throughout the year at a more equitable level than at present, and subject to the dictation of the financial advisors of the Government and deprived of the privilege of note-issue, the Imperial Bank of India has failed to develop into "a real national institution."

In spite of its humble services which should on no account be belittled or ignored,† it has not given satisfaction to anybody except perhaps its shareholders. The general public feel sorely disappointed at the slow progress of the Indianization scheme of its officers and apprentices. The Indian Joint-Stock Banks have no love lost for this "State-aided competitor." The Exchange Banks are apprehensive that their exchange monopoly would be jeopardized by making the Imperial Bank of India an ordinary Joint-Stock Bank and granting it full freedom to conduct any business which its shareholders would determine as soon as it sheds its semi-Central Banking character. It would excite the envy and dissatisfaction of the existing banks whose business would have to be encroached upon to maintain its present high rate of dividend, viz., 16 per cent. They would surely consider it as a millstone tied round their neck.

As it is, it is a commercial bank with about 200 branches extending far and wide over the whole country. As a commercial bank it has come into open competition with the other kinds of banks transacting business in the interior. Its anxiety to extend banking facilities has forced it to spread a

* This was first published in the *Mysore Economic Journal*, Sept., 1930.

† See my *Present Day Banking in India*, Third Edition, Chapter on 'The Imperial Bank of India.'

network of commercial branches and they are slowly building up business connections at these different centres.

Now that the idea of its being developed into a Central Bank has been disapproved by the Hilton Young Commission itself, a new Central Bank would have to be created. With the formation of a new Central Bank all irksome restrictions on the character of its business would be removed. Perhaps it would be one among the different banks selected to act as a Government Depository. With a London Office free to conduct commercial banking, exchange business would naturally be thought of. The technique of exchange banking is not difficult for it to master and as it has best experts in its hands and branches all over the country, it would prove the most formidable competitor to the existing Exchange Banks. But exchange business is being already satisfactorily discharged by about 18 banks who are finding it difficult to maintain their existing rate of dividend as a result of excessive competition amongst themselves. The advent of the Imperial Bank into the ring would make matters worse. Nobody knows the exact strength of the Indian shareholders of the Imperial Bank.† Granted that it is about 45 per cent., it clearly follows that the Imperial Bank would soon join the ranks of the Exchange Banks. When it attracts London deposits, as do the present Exchange Banks, it would be London money that would be financing our foreign trade. The main problem of conducting the financing of foreign trade with domestic funds would be defeated. It can easily fraternise with the existing Exchange Banks. By becoming a member of the Exchange Banks Association it would doubtless follow the same policy as that of the rest of the Exchange Banks. At present there is a lot of dissatisfaction at the treatment meted out to the Indian customers by the foreign Exchange Banks. As a member of the same Association it

† See Evidence of Managing Governor, Imperial Bank, before the C. B. Enquiry Committee

would undoubtedly continue the best traditions of these Exchange Banks.

It must be remembered that as soon as the Central Bank is started with branches at the regional centres such as Cawnpore, Lahore, Rangoon, Bombay, Calcutta and Madras, the bulk of the Government interest-free deposit money would be withdrawn. The clearing accounts of the other banks would also be withdrawn if the Reserve Bank undertakes to act as a Settling Bank for clearing purposes. Becoming an ordinary bank it would have to pay current accounts at the rates which the other competing banks are paying. The maintenance of branches and the necessity to pay the depositors point out that its success would depend on a *constant and steady turnover of its capital resources*. So the suggestion that it should be converted into a big Industrial Bank, for it has expert management at its back, business connections with industries and a regional character to enable it to initiate the policy of the financing of industries, is not based on sound reasoning. Non-terminable loans and continuous locking up of capital for a lengthy period would reduce its turnover of capital and it would be unable to maintain the existing rate of dividend to the shareholders. It would require a lot of inequitable sacrifices on the part of the shareholders. After all it is not the mere lack of financial resources and facilities that is standing in the way of the industrial progress of this country.

With a long record of honourable service the Imperial Bank ought to excel all other banks in its deposit business, security dealings and trade credits and be behind the Exchange Banks in respect of its vigour in pursuit of the foreign exchange business. For the unique distinction of being a bank for industry, par excellence, to which all other branches of activity are to be subordinated, the Imperial Bank cannot hope to aspire on account of its excessive capital and present-day high dividends.

§ See the Banking number of the *Indian Finance*, January 8, 1930.

Acting as the chief provider of short-term capital for the co-operative banks, and holding the debentures that would be floated by the provincial land mortgage banks as part of its investments, it can easily afford to continue its present commercial character which does not however preclude it either from financing the existing industries in which it might have confidence or conducting exchange business to satisfy all the requirements of its existing customers. But it must bear in mind that it should not be saddled with heavy external deposits attracted in London. The collection of these heavy external deposits for use in this country might cement the financial ties between London and this country, but this policy needs very judicious handling on the part of the Imperial Bank. London deposits might be lying in its hands for a long time but these must be covered sufficiently by quick London assets. Heavy Indian assets would not help the London branch in case of a drain on the London branch. So if it were to develop into an Industrial Bank its London branch would be a costly luxury. Long-term capital can indeed be tapped by floating debentures and if these are to be floated for 10 to 20 times its present capital the demand for industrial capital would not arise to such an extent as to absorb a part of the industrial capital supply created by the Imperial Bank.

Thus the future business of the Imperial Bank may be extraordinarily wide or restricted. It depends on its own choice. It can carry on banking business, acquire deposits, make advances, discount bills, issue drafts, deal in exchanges, specie and precious metals. It would be empowered to borrow money and do anything incidental to any of its powers and it would continue the policy of opening new branches as in the past. It may compete more vigorously than at present with the existing Banks. If it were to continue holding Government deposits, though to a limited extent than at present, it has to maintain a very liquid position and this alone will enable it to maintain the financial prestige which it has built-up out of a long and honourable record of service.

It is quite fit to conduct exchange banking or industrial banking involving a large turnover of funds into lock-up advances. But the exigencies of the situation demand its continuance as a true commercial bank—as a bank of deposit, discount and exchange. Its savings Bank Department should continue. It can likewise maintain a separate Industrial Credit department where long-term loans can be given to co-operative banks, industries and other banks. Any additional money needed for this business can be secured by floating debentures. This must be definitely understood as non-commercial business and not allowed to directly clash with its commercial business. Thus envisaged its future seems to be of a big commercial bank combining within itself miscellaneous functions of all sorts which would be kept entirely apart from the pure functions of a commercial bank and should on no score be allowed to distract the responsible administration of the Imperial Bank. Enough has been stated to stress the points that it would be dangerous and suicidal to convert the present Imperial Bank of India into an effective Industrial Bank or a sole Exchange Bank operating on a competitive basis with the existing exchange banking institutions.

Considering the fact that the most crying need of India is the extension of modern banking facilities to the interior, the Imperial Bank should continue this useful service in the near future.* Whether subsidised to the amount recommended by the Hilton-Young Commission or not, it should continue to act as a commercial bank and be the acknowledged head of the commercial banks standing ever ready to tap the central reservoir of credit by rediscounting agricultural, industrial and commercial paper and passing on these funds to the co-operative societies which would be financing the agricultural industries, the cottage industries and other existing industries so far as their current financial requirements might be concerned.

* There is no advantage gained by allowing it to continue as a "hybrid institution trying painfully to combine incompatible functions" as Sir Basil Blackett describes it. See his address before Delhi University, 1926.