

With the compliments of
INDIA'S *J. C. Coyajee*
CURRENCY AND EXCHANGE

PROBLEMS

1925—1927

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BY

J. C. COYAJEE

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NOTE.

I venture to place this brochure before the public in the hope that it might assist the public in general and students of economic matters in particular, to make up their minds about the main issues in the present controversy on Indian Exchange and Currency. The articles contained in the brochure have appeared as recent contributions to local newspapers. I am obliged to the "*Statesman*" for the publication of one of the interviews. My obligations are even greater to the "*Forward*" and to its editors who have displayed a generous and impartial spirit in allowing many of the other contributions to appear in its columns. Obviously a newspaper follows the true path of journalistic duty when it allows both sides to have their say, leaving the public to sit in judgment on the issues. I have also to thank Mr. H. Sinha, M. Sc., Mr. Manoranjan Bhattacharyya M. A. and Mr. S. Roy M. A. for encouragement or assistance in getting the pages through the press.

J. C. C.

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THE 1s. 6d. RATIO AND AGRICULTURE *
IS ADJUSTMENT TO 1s. 6d, COMPLETE ?
*VERDICT OF CO-OPERATIVE
STATISTICS*
ISSUES RAISED IN THE CONTROVERSY

The first question put to the professor was whether the adjustment to the new ratio had already come about and, if so, what were the economic tests to be applied.

"In my opinion" replied Prof. Coyajee, "the method selected by the Royal Currency Commission to prove the fact of the new adjustment is a proper and convincing one. It shows the adjustment of prices to the ratio, by demonstrating a close relation over a sufficiently long period between former prices in India and the rise of exchange."

A Table with Triple Distinction.

When asked to elaborate his views in this matter, he proceeded to say: "Let us turn to the table cited in the Minute of Dissent, paragraph 94. This table has enjoyed the triple good fortune of having been utilised by the writers of the Report; of having been accepted and cited by Sir Purshottamdas Thakurdas; and of having been brought up-to-date by the Finance Member himself. This table thus can be accepted for the purposes of this controversy.

"Sir Basil Blackett deduced the following results from this table: '80 per cent. of the adjustment of prices of commodities at 1s. 6d. ratio had already taken place a month before the Commission's report.' In this at least, Sir Purshottamdas is not behind the Finance Member and makes a notable admission, which has not been properly remarked upon."

*This interview appeared in the "*Forward*" of Dec. 24, 1926.

What is Admitted ?

Asked as to what was implied in that admission Prof. Coyajee referred to the table published in the "Times of India" dated November 27, and pointed out that, according to Sir P. Thakurdas, out of adjustment of 36 points (176—140) between December, 1922 and May, 1926, an adjustment of 26 points (176—150) had already been achieved. He then went on; "This implies that an adjustment of 73 p. c. has already taken place, which is a great deal of adjustment to expect in complicated economic matters. Further, the value of the admission by Sir Purshottamdas is greatly enhanced by other collateral considerations."

Inconsistencies of Sir P. Thakurdas.

When requested to explain these "collateral considerations," he pointed out that Sir P. Thakurdas was inconsistent when he argued that the process of adjustment of domestic prices to exchange was slow and at the same time assumed that foreign prices quickly reacted on Indian prices. "Sir Purshottamdas would have admitted the full eighty per cent. adjustment, but for the fact that according to him the American prices had fallen by 4 points, Indian prices had been adjusted to this fall forthwith and allowance should be made for this circumstance. But as coming from him it is difficult for us to accept such a quick adjustment of Indian to foreign prices. Indeed his whole case is that in India the adjustment of prices to the exchange is a very slow process indeed. But if this is so, why should the adjustment of Indian prices to foreign prices be so rapid a process as he would now make it out to be when it suits his case—specially as the pace of both sets of adjustment depends on the same circumstance, viz., the proportion of the foreign trade transactions of India to her total commercial transactions. When allowance is made for this consideration, there is little real difference between the position of Sir Purshottamdas and that of the Finance Member. It is therefore inconsistent for Sir Purshottamdas to write in the columns of the "Times of

"India" of November 27, 1926 that the utmost that he would concede was that the disturbances involved in the reversion of 1s. 4d should be as great as the disturbances seem to come with the adoption of 1s. 6d. He is contradicting himself. Having admitted an adjustment of more than 73 percent, he now asserts that adjustment is 50 per cent only. Consequently, in his comparison of 'the arithmetic of both of us' he does not come out so triumphantly as he imagines."

Other "Inconsistencies.

When our reporter pointed out that Sir P. Thakurdas was an able but not the only protagonist for 1s. 4d Prof. Coyajee went on to say, "There are further admissions by other notable authorities on the same side. The fact of adjustment is so undisputable and undeniable and so all-pervading a factor in our economic situation that many of our critics pass it over with wonderful naivete. To take an example, Mr. Madon in his able work on EXCHANGE FALLACIES EXPOSED Part II, pages 15 and 16, urges that the twisting of exchange up from 1s. 4d. to 1s. 6d. means that all agriculturists must find $12\frac{1}{2}$ per cent. more in the shape of commodities, to meet the charge for interest as well as the debts. But, surely, this is to admit the fact of the fall of prices in commodities in accordance with the new ratio. Because, to say that more goods have to be given for each rupee is the same thing as to say that prices have fallen by $12\frac{1}{2}$ per cent. fully."

"Mr. Madon makes a similar admission when he talks of the additional burden on land revenue and agriculturists which 'is today extracting $12\frac{1}{2}$ per cent. more out of those who have to pay land revenue or rent.' Surely such an able writer as Mr. Madon must not have failed to see that the same appreciated rupee will go further than before in the cultivator's purchases. Thus his cost of living and of production will also fall by $12\frac{1}{2}$ per cent. in terms of the rupee."

Condition of Agriculturists.

The conversation then turned towards the condition of the

agriculturists. Our interviewer pointed out that there was an acute difference of opinion on the subject and enquired what economic tests could be applied to ascertain the present condition of Indian agriculture. "In my opinion," replied the professor, "the Co-operative Societies form a microcosm and give a general idea of the condition of agriculture in India, partly because of the frequent reports published on the conditions of the standard of indebtedness, rate of interest, punctuality in repayment etc., and partly because numerous non-official workers interest themselves in the matter and supplement official reports from first hand knowledge. "Now if the alleged great increase of the burden of debt and the material reduction of cultivators' income were positive facts, we would expect to see the following symptoms making their appearance without fail: (a) the growth of the capital and deposit of the rural societies would have been materially checked and even reduced; (b) proportion of arrears to outstandings would increase largely; (c) the rate of interest would rise remarkably; and (d) loans for unproductive purposes, like repayment of debt, would increase materially."

Growth of Agricultural Capital.

"Coming to the first factor we find a very steady increase of deposit, and share-capital during the whole period when the exchange had been 1s. 6d. The 'Co-operative Statistics' of 1923-24 showed that capital was increasing steadily and stood during September at Rs. 175 per member. The working capital of Central Banks had also increased in the course of the year. "The co-operative Statistics of 1924-25 showed a similar increase of resources. Capital had increased to Rs. 183 per member, while average capital per society had gone up to Rs. 6,730 from Rs. 6,682 in the earlier year. Such a state of things would have been impossible when anything affected an agricultural district.

"Let us come now to arrears and overdues. Here also the figures are as significant as before and more decline has come about.

"As regards the rate of interest, there is no rise at all. On the other hand, during the year of 1923-24 in the United Provinces, the number of Primary Societies which completed 10 years of working were allowed the facilities of getting loans from the Central Bank at reduced rate."

Loans for Productive purposes.

"Nor is there any sign of any growth of loans for unproductive purposes. The Bombay report of 1924-25 notices that in some places instances were not wanting to indicate that members of the societies had improved their economic condition to such an extent that leaving aside the question of dealing with the Baniyas they had ceased to borrow even from the Societies. The Punjab Report of 1924-25, which analyses the purposes of loans does not show any alteration in their purposes. The Madras Report of 1924-25 observes that tabular analysis of loans indicates that the percentage of loans for non-productive purposes continued to decrease. In the year 1924-25 only Rupees 2.62 lakhs were lent out of the total amount of Rupees 158.33 lakhs. Considering that Madras is an agricultural province and not a rich one at that, we might have expected a vastly larger proportion of loans for redemption of debts, if the burdens on agriculturists were anything like what they have been alluded to be."

The alleged "Farmers' ruin."

"I hope shortly to place before the public a detailed study of these questions. I may remark that even more instructive than the official reports would be to glance at the numerous articles appearing in our Co-operative Journals. These articles are contributed by voluntary and non-official workers who are fully in touch with agricultural conditions. None of them seems to have heard of 'the farmers' ruin' or even of the abnormal distress. In fact that piece of information seems to be the cherished monopoly of a few Bombay industrialists and their friends."

RYOT AND 1s. 6d. RUPEE *
**HAS THE AGRICULTURIST SUFFERED
A NET LOSS?**

CURRENCY REPORT JUSTIFIED

Interviewed on behalf of the *Statesman* with regard to the movement in Bombay against the recommendations of the Currency Commission, Professor J. C. Coyajee of the Presidency College in this city and a member of the Commission, gave the following replies to the questions put to him:—

“What is your opinion as regards the facts and statistics brought forward to show that the 1s. 6d. rupee has injured the interests of the Indian agriculturist?”

“The contention has been put forward repeatedly and emphatically that the rise of exchange to 1s. 6d. has mulcted the agriculturist to the extent of 12½ per cent. of the value of his entire produce and has similarly added to his debts.

“Let us understand what this exactly means in order that we might realize the calamity which would have overtaken the country had the statement been entitled even to the dignity of a half-truth. The change in ratio has been alleged to be the equivalent of a tax of 12½ per cent. not merely on the profits of the farm, but on his whole produce and annual turnover. It is very difficult to envisage this burden without arithmetical figures; but fortunately there is no lack of statistical efforts to calculate the alleged stupendous levy. Mr. Madon finds that “the cultivator loses about 40 to 45 crores of rupees a year on some 360 crores of our exports and must lose at least another 40 to 45 crores a year on the portion of the crops that is consumed at home.”

* These views, expressed in course of an interview, appeared in the “*Statesman*” of 16th December, 1926.

"Presumably according to Mr. Madon this immense loss is *continuous*, going on from year to year, irrespective of any price adjustment. The Indian Merchants' Chamber of Bombay puts the increase in the real burden of the agriculturist's debt at 100 crores. Thus we are asked to believe that the annual loss to the agriculturists, due to the exchange ratio is about 200 crores of rupees. Indeed, these losses seem to be growing larger at each repetition, and assuming a *crescendo* movement. Mr. Khaitan goes further and argues that Indian agriculturists got Rs. 250 crores less per year on their crops alone. Further burdens have been added in the shape of losses caused by the rise of exchange to the mortgagees and lessees of agricultural lands. An additional 12½ per cent. loss is to be debited for the supposed increased incidence of the land revenue. To complete the tale of wrong to the agriculturists we heard last month that the agriculturist has lost a few hundred crores more by the fall in the price of silver—itsself the effect of the manipulation of exchange. Now if these calculations are at all correct the Indian agriculturist has been robbed of many hundreds of crores of rupees. The resources of the *ryots* must be unlimited indeed to have been able to stand all this."

Impossible Figures of Burdens.

"These are absolutely impossible figures. Surely, if the facts of life corresponded even remotely to such fearful anticipations, we would have unmistakable signs and symptoms of such a general cataclysm. The first thing we should see would be wide-spread default in the payment of land revenue. The Indian agriculturist, no doubt, honestly faces his normal burdens but such burdens as have recently been imagined for him, would break the back of the wealthiest agricultural community.

"The second symptom to be expected would be an immense number of suits and forfeiture proceedings instituted by *mahajans* and *suhukars* all over the country, because no creditor can rest in peace while his claims are being sub-

merged in such an avalanche of new liabilities, and by now immense areas of land should have passed into the hands of the *sahukars*. It might be remembered that a much smaller transfer of land to the creditor and the mortgagee brought on the agrarian disturbances which led to the passing of the Punjab Land Alienation Act and the Deccan Agriculturists' Relief Act.

"Mr. Madon tells us in the same pamphlet that the agriculturist 'has no spare money with which he can pay off the *sahukar*. The result will be eviction proceedings and the cultivator and his family will become landless and homeless wanderers going about the country as hired labourers to get such work as they can.' All these might be supposed to be reflected in the statistics of the law courts; and agricultural and urban wages would be profoundly influenced by such a state of things.

"Mr. Madon, having the courage of his conviction, argues that 'the 18d. rupee leads to a loss to the agriculturist not only of 12½ per cent. of the price, but of all the 100 per cent of his net earnings, and a further loss of Rs. 20 a *khandy*. It will be at once seen that he will have no margin left to meet either the Government dues or the dues of the *sahukar* and will have to borrow an additional Rs. 20 per *khandy* merely to meet his actual outgoings and keep body and soul together.' Needless to say, every line of the statistics of India must bear witness to such a state of things. But as a matter of fact, the statistics of the country have kept going on an even and smooth course and have shown no trace of any, such upsetting factor."

Evidences of Agricultural Prosperity

"What aspect of agricultural economy would you mainly emphasize as disproving the contentions of the advocates of the 1s. 4d. rupee?"

"A study of the last three years' reports of co-operative societies is the most convincing answer to the allegations of

the "farmer's ruin." Let us glance at a few relevant incidents in the co-operative history of the last two or three years. The report of co-operative societies in Bombay for 1924-25 informs us of the all-round progress of central banks, and of the increase of their share capital. The deposits from primary societies in these banks increased largely. The Madras report for the same year shows the following features ; the addition of 1,200 new societies, the persistent fall of loans for non-productive purposes ; and the steady growth of the reserve and deposits of central banks. In the same presidency, the year 1923-24 saw a reduction of the rate of interest and yet the societies continued to work at a profit, while the Registrar observed that the reduction of interest was fully justified. The story can be repeated from other provinces."

Debtors and Creditors.

"How far have the agriculturists been penalized by the higher ratio in their capacity as debtors ?"

"The question of equity as between the agriculturist and his creditor is highly complicated and with regard to it easy generalizations are out of place. A little economic analysis might be offered to clear the issues.

"(1) Even assuming that such an increase of burden to the tune of 12½ per cent. has taken place, we should not forget that it is only a partial set off against the earlier and much larger reduction of his debts. Surely, if the agriculturist is entitled to justice, so is his creditor. It is an undeniable fact that the real burden of the farmers' pre-war debts has been greatly reduced, since the purchasing power of the rupee is much lower now than it was in 1914. For many years prices have been falling, with the result that all creditors have been losing and all debtors have been gaining, and the case of the agriculturist is only one out of many. With the reversal of the process, the creditor is only getting back some of his own. To

perpetuate the old state of things would be to perpetuate an injustice.

“(2) It is generally known that in the case of the Indian agriculturist, the renewal of debts at intervals is a very common practice. As the renewal takes place on a rupee for rupee basis, we have another way in which rural indebtedness has been scaled down during the period of rising prices.

“(3) We have also to remember that a great deal of the rural debt is incurred in kind, *i. e.*, in grain. So far as this is the case an appreciation or depreciation of the rupee can matter little to the Indian agriculturist. On the other hand, four or five bumper crops must have reduced that kind of indebtedness very materially.

“(4) In India most of the agriculturist's debt consists of short period obligations; and all these must have been incurred necessarily in the last two or three years. As regards this mass of indebtedness no one can even suggest the possibility of the exchange doing any injury to the ryot.

The fact is that it is only by jumbling up old debts and new debts, original debts and renewed debts, short period and long period obligations, debts in kind and money debts, that a plausible case has been put forward for the “farmer's ruin.”

The fall in purchasing power.

“Do you agree with the assertion that the exchange policy has been the cause of the fall in the purchasing power of the ryot?”

“A great deal has been made of the fact that the Indian agriculturist has been purchasing a smaller quantity of piece-goods than usual, and this has been held as a proof of the blow dealt by the exchange policy to his prosperity. But, in the first place, we note that it was only to be expected that the agriculturist should transfer his custom to the precious metals which have fallen in value very materially. In the second place, with successive heavy crops the relative price

of the farmer's products has fallen in India (as elsewhere), while the prices of other commodities have remained comparatively higher. The same phenomenon has been attracting a great deal of attention in America and a very able writer has put forward the view that 'in so far as the farmer's financial outlay is for goods, his chief concern is that there be no disparity between the prices of his own products and those of other things.' Whenever such disparity has appeared between agricultural prices and the prices of other commodities, the farmer naturally hesitates to make purchases on the usual scale.

"In India the agriculturist finds that successive large harvests have brought down the price of his goods, while the prices of piece-goods have been comparatively little affected. He is, therefore, content to bide his time and wait for a fall in the prices of textile goods, and meanwhile invests his savings in gold and silver. One should not therefore believe that because he does not purchase textile goods as before his resources are exhausted; witness the unexpected and unwonted resource shown by the Indian farmer in holding up his jute and cotton in the face of low prices."

Narrow Limits of the Influence of Exchange.

"What are the limits to the influence of any exchange policy on the prosperity of agriculture?"

"My answer is that exchange policy can directly and in the main influence only the general price-level; while what the agriculturist is now suffering from is the condition of relative prices—*i. e.*, the prices of agricultural produce have gone down relatively to the prices of other commodities.

"It is necessary to see that such a complicated problem as that of the reaction of the higher exchange on the fortunes of the agriculturists is not to be solved by the free use of popular slogans. We have just had an example in another country of the consequences of the reckless use of such

slogans as—'Not a minute, on our day; not a penny off our pay.' There is a family resemblance between that shibboleth and another which we have been hearing in this connection in India for a couple of years—'Twelve per cent.' on farmer's debt; 'Twelve per cent.' off his income, net."

THE TRUTH AS REGARDS MANIPULATION OF CURRENCY *

THE RATIO OF 1s. 6d AND ITS MAINTAINABILITY

The critics of the Report of the Royal Currency Commission have argued that "the ratio of 1s. 6d. was attained by official administration of the currency" and a drastic process of deflation. They have further alleged that as that ratio is a forced ratio (and not the "natural" ratio), it can be maintained only a little further by a policy of continuous deflation; but that ultimately the ratio cannot be maintained since its maintenance "would expose the resources of the Government of India to the point of deflation" (Minute of dissent paras. 68—70 and 128). These allegations deserve to be examined carefully.

War-Time Inflation

It will soon appear that both the extent and the influence of the preliminary deflation of the period ending in August 1923 have been greatly exaggerated. Having regard to the great inflation of our currency during and after the war which raised the circulation of rupees and notes from 248 crores in 1914 to 407 crores in 1918—and which the author of the dissenting minute himself terms "an immense inflation"—the subsequent deflation was both partial and hesitating. As an authority on Indian finance has put it: "the existence of budget deficits of a substantial amount clearly made currency contraction a matter of unusual difficulty, but in the three years 1920-21, 1921-22 and 1922-23 Government was able to effect a reduction in the currency circulation amounting to Rs. 33 $\frac{1}{2}$ crores". The minute of dissent admits that taking the last five years together, even during the epoch of deflation the average expansion of currency was 12.12 crores a year

* This was the first of a series of articles contributed to the "Forward" and appeared on 9th January, 1927.

(paragraph 63). Only it expresses a regret that the pre-war average expansion of currency (viz. 20 crores of rupees per annum) was not maintained all through. The answer to this obviously is that we cannot conceive of a normal rate of currency expansion which should be carried on at all times irrespective of the relative demand and supply of currency at home or of important movements of prices abroad. It is hard to conceive why expansion of currency should proceed in India at full speed regardless of the "immense inflation" which proceeded or of "the tremendous fall in world prices" which was contemporaneous with the deflation in our currency. The idea of carrying on an average expansion of currency, regardless of radical changes in conditions, is worthy of the best traditions of inflationism.

Influence of Contraction

The influence of the contraction on Exchange and on prices has also been exaggerated. Thus in 1920-21 when the net contraction was about $31\frac{1}{2}$ crores (i.e. when by far the greatest portion of the preliminary deflation had been already carried out) such deflation failed even to check the downward course of the rupee. Surely this is proof positive that the deflation was nothing like so drastic as has been alleged. Another proof of the same, if indeed more proof was wanted, is that the fall of prices in India was much smaller than the very substantial fall which was taking place at the same time abroad. It was well observed that an automatic system would have required an even greater contraction in India.

The fact is that neither in 1924-25 nor in the epoch of 1898 (when the Exchange was raised to ls. 4d.) was contraction of currency the main factor in the raising of exchange, although at both periods a great deal was made of such contraction of currency as had taken place. In both cases the great factors of the economic situation of the world and the favourable balances of trade on the part of India formed the dominating elements in the maintenance of exchange. But on both occasions the business community was up in arms

against such deflation as took place. This illustrates the remarks of Sir James Brunyate that the Indian money markets are disposed to be somewhat specially intolerant of deflation and that there is a disposition among them to expect more in this line from the Government of India than is expected in other countries from their controlling financial authorities.

Inconsistency of Critics

It might be noted in passing that there is a certain inconsistency in the attitude of the critics of the Currency Reports as regards the topics of the contraction of currency and the adjustment of prices. On the one hand they do their very best to exaggerate the contraction of Currency; on the other hand they stoutly deny that prices have fallen so as to adjust themselves to the ratio. To the economist there is a startling anomaly in the same party's assuming both these positions. There was no reconciling these attitudes except by denying the Quantity Theory: and that bold step was taken before the Commission by no less a critic than Mr. B. F. Madon. Economic history shows that it is impossible to advocate inflation, even in a veiled manner, without throwing overboard the Quantity Theory. Monetary fallacies cannot survive in its searching light.

Recent Deflation

Since the Currency Report was issued our critics have again raised the cry of deflation. But I would request them to bear in mind the following circumstances:

(a) The Currency has been expanded too in every one of the recent years, for meeting seasonal requirements as well as for securing funds for the purchases of sterling by Government.

(b) Large quantities of hoarded currency have come into circulation in recent years, having been replaced by gold in the hoards. Hence the large return of rupees from

circulation during the slack season and also the exceptionally small absorption of rupees in the busy season.

(c) As the Controller of Currency observes, the cash balances of the Imperial Bank bear witness to the redundancy of Currency during the slack season. Nor should one fail to note the slackening of the grip of seasonal stringency in recent years.

Maintainability of 18d. Ratio

Having thus shown that the complaints, as regards the deflation having been of a diastolic character, are themselves exaggerated, we might come to discuss the second question to be dealt with in this paper, viz., the maintainability of the ratio of 1s. 6d. There are three aspects of the problem of maintainability.

(1) It might be argued that it is easier, generally speaking, to maintain a lower ratio like 1s. 4d. than a higher ratio like 1s. 6d. To this the answer is that, once an adjustment of prices has taken place, it is no more difficult to maintain the higher than the lower ratio, because with the higher exchange ratio and lower internal prices our products cost the same to the foreigner and have the same world price in terms of gold as they would with a lower exchange ratio and correspondingly higher internal prices.

(2) It has been argued that, in the case of an unfavourable monsoon, the higher ratio would be more difficult to maintain than a lower ratio. But here also the difficulty would be no greater, once our prices have adjusted themselves to the ratio. To quote an eminent expert, "Any rate established over a period of normal years must tend to break down in bad years unless sustained by the exchange machinery."

(3) It has been contended that we are entering on a long period of low world prices and that a higher ratio will be against the interest of India under such conditions and, generally speaking, that it cannot be maintained.

Another Inconsistency

Before dealing with this contention, I venture to point out another glaring inconsistency or anomaly on the part of the critics of the Report. If they are so apprehensive of the evil effects of a fall of world prices, it is curious that they insist on demanding a gold currency which would form a considerable drain on the gold resources of the world and would materially contribute towards ushering in a period of falling prices. It is most inconsistent to express apprehensions of an imminent fall of world prices and yet to propose to make large drafts on the available gold supply of the world, which is a sure way of aggravating any possible fall of prices in the world. Thus our critics can be hardly regarded as serious when making this move.

Still, their contention must be considered here for what it is worth. Supposing, for the sake of argument, that a period of steady and substantial fall of prices is coming on, what is the value of the remedy proposed by them? Who ever contended seriously that a local inflation of currency, say by 12½ per cent., is a panacea for low prices all over the world? We had a long period of depression of prices in the seventies and eighties of the last century; but hardly any one seriously advocated local inflation as a remedy. Supposing we did try the inflation by lowering exchange, how long would it be before a readjustment of costs of production and of living supervened to deprive our industrialist and agriculturist of any short-lived advantage thus artificially secured?

Will Prices Fall?

So much of the remedy proposed. But in the first place, are we so sure that a long period of steadily falling prices is imminent? It is true that, as Professor Cassel points out, according to the Index number of the United States Bureau of Labour the prices in the years 1923, 1924 and 1925 are to be represented as 154, 150 and 159; whereas the prices in August

1926, stood at 149. But Prof. Cassel does not consider this a sufficient basis for apprehension as to prices. He observes in his latest communication: "Whether this fall of prices signifies any thing more than a reaction from a small boom, it is too early to decide. We are still justified in hoping that the United States will succeed in maintaining on the whole the price level which has subsisted in the last few years." This attitude is any thing but pessimistic as regards the future of the prices ruling in the world. He goes on to say that "with a judicious use of gold reserves, which hitherto have practically been left untouched, it should be possible for a fairly long time ahead to maintain with perfect security a price level of, say, about 150." Hence, to say that Prof. Cassel prophesies an imminent fall of prices is not true. His warning is only against any increase of new demands for gold: for the rise of such new demands would not only by itself increase the shortage of gold but "would also increase the eagerness of various countries to guard their accumulated gold reserves and, if possible, to increase them."

Surplus Stock of Gold

There are, in fact, numerous circumstances which would tend to counteract any steady fall of world prices. We note, in the first place, the great surplus stock of gold in the United States which that country would unhesitatingly use to offset any serious fall of world prices; for such a fall would be against the interests of that country itself as a leading industrial area. Not only is such a great stock of gold ready to be thrown into the scale, but, as Prof. Sprague of Harvard told the Currency Commission, the reserve Banks of America could easily reduce their reserves from 70 to 50 per cent. and thus release an additional 800 million dollars. Another 700 million dollars could be made available by a substitution of Federal Reserve notes for gold certificates. The conclusion is that "the excess reserves of the United States are sufficient to supply any deficiency in the world's gold production for a good many years."

But the economy of gold will not be confined to the American Banks. A reference to the reports of the banks of Europe will show a very important factor at work—foreign exchange represents the cash reserves of banks in so many countries in place of gold. Again, as Prof. Cannan of the London University observed before the Currency Commission, the production of gold would automatically increase if a substantial fall of prices took place, because there is a considerable amount of gold produced on the margin. Thus we have very little to fear as regards the maintainability of our exchange unless we ourselves begin the introduction of gold currency at the wrong time i. e. when there is a great need to economise the gold resources of the world in the general interest.

Certain Dynamic Factors

In conclusion, I would emphasize certain dynamic factors which are specially favourable to the maintenance of the 1s. 6d. ratio by India. In the first place, the favourable balance of trade of India which has been steadily rising for decades, and which never rose so rapidly as now, will undoubtedly play a decisive part in the maintenance of the 1s. 6d. ratio. In the second place, there is to be counted on the great repurchase by India of its own securities during and after the war. The process of converting our external debt into an internal debt is going on rapidly and steadily, and it is to be noted that in some foreign countries this process of buying back national securities has sufficed by itself to raise and maintain the exchange. Finally, in future we might count on the growing demand of the western countries for our raw materials during the period of the revival of industries when the industrial and trade depression which forms the aftermath of war has passed away.

THE RYOT AND THE RATIO

So numerous have been the aspects of Indian agriculture brought into issue in the present controversy regarding Indian currency and exchange, that it is necessary to advert to them again for a time.

The Verdict of Co-operative Statistics

In the interview published sometime back in the columns of this paper, I have argued that the progress and prosperity of rural Co-operation in India constitute the best answer to the repeated allegation that the Indian farmer has been ruined by the rise of exchange to 1s. 6d. So damaging to our critics was this verdict of Co-operative Statistics that an attempt has been recently made to minimize its force by arguing that the Co-operative bodies form but a small part of the system of Indian agriculture. Consequently, it was contended that we could not argue from the prosperity of the one to the prosperity of the other.

To this the answer is that Co-operative Societies, being scattered and spread evenly over the whole country, are fairly representative of the country's agricultural conditions. So far there never has been any question about their representative character: none of our numerous economic enquiries or land settlement reports has made any distinction between villages possessing Co-operative Societies and those without. The method of "sampling" is well-known in statistical enquiries. In this case we are in the fortunate position of being able to apply this method of "sampling" with a vengeance to the problem in hand—because we are dealing with about 70,000 samples in the shape of rural Co-operative Societies, while many thousands of more are being formed every year. Surely, arguments drawn from so many samples so evenly distributed can claim to be unshakable. But above all, if, as has been alleged, there is general and pronounced agricultural distress, how can the Co-operative Societies be immune from it? In

* This article appeared in the 'Forward' of 18th January, 1927.

leads only to corresponding additional taxation in other ways ; and some portion of the extra taxation in pre-war days has to be explained in this way. In this connection, the reader's attention should be drawn to the remarks on this aspect of the problem made by Sir Robert Giffen, the famous statistician and economist, before the Fowler Committee. He pointed out that a rise of prices due to monetary inflation is equivalent to a remission of taxation, since the Government obtains the same number of rupees as before, but depreciated in value ; consequently, resort must be had to additional taxation to make good the State's income.

On this point also there is noteworthy disagreement among the critics of the report. Mr. Madon argues that, as the result of the rise of exchange, Government gets more out of the farmer, while Sir Purushottamdas suggested that, as a consequence of the rise, the revenues would be reduced (*vide* his questions No. 85-92 in the evidence before the Currency Commission). Which of these gentlemen is right ?

Who Gains What The Farmer Loses ?

This is a very interesting and relevant question and is worth examining, in spite of the opinion of a Bombay critic who recently observed that "if the loss is proved, it is secondary as to who profits by that loss." With all respect, it seems to us very important to trace the gain of so many millions per annum. If we could find some class who had become suddenly very rich in the last two or three years, the fact of the farmer's ruin would be irrefutably established. But as to the identity of this beneficiary we are not given much information. A suggestion has been made that "a very small number of bankers, financiers and investors" have profited by the alleged immense losses of the farmer. But if such had been the case, indeed, banking and investing would have become extraordinarily profitable occupations in the last two or three years ; and the statistics of banking and financing tell us no such tale of the accruing of vast unearned increments. Others have suspected the importer of gaining the rupee

recently argued that the total imports of silver into India between 1835 and 1925 amounted in value to 913 crores of rupees. Of this mass of silver the value has fallen by 400 crores on account of the alleged manipulation of currency; and much of this alleged loss must needs have fallen on the agriculturist. With reference to this sort of contention, I would draw the attention of the reader to an article by Mr. Joseph Kitchin in the "Financial News" of 29th October, 1926. In that article Mr. Kitchin examined the various recommendations and showed that there was nothing in them which could have or should have produced the recent drop in the silver quotation. An unfounded and sentimental fear arising from the proposals might have had some undesirable effect. But no Commission can prevent a misreading of its recommendations: and according to Mr. Kitchin the most tangible reason for the fall in the price of silver is given by the temporarily lessened demand on the part of China and India. Sir Purushottamdas himself—who, to do him justice, does not countenance the extreme statements made by his followers—has recently observed to a Bombay audience that "to-day silver prices are very low due to world causes," and all that he emphasized was the apprehension entertained as regards future action in the matter of the surplus silver holding.

But if the mere apprehensions as regards the potential and future action of the Government, or such as were roused by the misreading of a report, produced such an effect on the silver market, how much greater would have been the fall of silver had the alternative favoured by our critics—the immediate introduction of a gold currency—been adopted? Then indeed there would have been no sense in calling the apprehensions sentimental; then there would have been a real and unprecedented *debacle*. How easy it is to see a mote in another's eye and how difficult to observe the beam in one's own! Some stalwarts, however, have freely admitted the immense loss "to the Indian masses" when silver falls in price on the introduction of gold currency but they go on to say "that is the least

any case, their financial conditions 'must at least be made worse' if such conditions existed. But as a matter of fact we find their finances improving very noticeably. The inference is obvious.

The Agriculturist's Interest In Imports

We might now proceed to examine another favourite contention of the critics of the Report. This is to the effect that the agriculturist hardly benefits by the cheapening of imports (through the rise of exchange) to any appreciable extent. For example, Mr. Madon believes that the cheapening of imports can only benefit the wealthier classes at the expense of the producer. But, surely, he will agree that the agriculturist is greatly interested in the large imports of railway and other material, of all accessories of irrigation, of agricultural implements, of imported yarn and, to some extent of piece-goods. Let me quote one who is known all over India as a great scientist and who has for years made an intensive study of rural India by spending all his time in travelling through the districts and studying their condition. I refer, of course, to Sir P. C. Roy whose intimate knowledge no one will question and who very recently complained before the Royal Agricultural Commission that "owing to the increased price of jute there has certainly been a larger circulation of money, but the *largest percentage of that money is now sent away in the shape of purchases of foreign imported goods for which our ignorant rustics have a kind of fancy.*" Other observers have recently noticed that in Bengal the standard of living of village labourers and cultivating peasants has decidedly improved and they are using foreign imports in the shape of piece-goods, trinkets, cheap stationery etc.. Indeed it has been remarked that while imported piece-goods are being less used by the "*bhadralokas*" in the town, they are being more and more patronised by the peasant class in the villages.

The Agriculturist And The Price Of Silver.

We might proceed to notice a fresh item in the indictment of the Government's currency policy. Thus it has been

millions which the farmer is said to have lost. But, surely, if the import trade people had been gathering the shekels in such abundance, that trade would have been making great strides forward. But what are the actual facts? The last Review of Trade informs us that "during the last three years the volume of India's Export Trade has regained its pre-war level, while, for import trade, recovery is still very far from being complete." So it does not look as if the import trade had been making exceptional gains. Finally, at the last Economic Conference, Mr. Madon, when questioned on the point, suggested that the Government had been gaining what the farmer had been losing, on the ground that it had made a gain of three crores or so on its sterling expenditure. He did not trace any connection—either arithmetical or theoretical—between the three crores gained by the Government and the two or three hundreds of crores alleged to have been lost by the Indian agriculturists.

World Factors Affecting Agriculture

When we take into consideration the last decade or so, we find that there has been a race between agricultural prices and the prices of manufactured goods, so that the advantage has sometimes been with the agriculturist and sometimes with the manufacturer. In the last five years the agriculturist has been losing and, relatively speaking, the prices of his wares have been falling. This state of things, however, has nothing to do with exchange nor is at all peculiar to India; and the relative fall of agricultural prices might be said to be a world-wide phenomenon. Thus in America, it has been observed that "the continued concentration of price declines on the products of the farm has brought about a disturbance of the price equilibrium." On this subject, I had the privilege of examining Dr. Hollander before the Currency Commission. He observed that the general opinion was that, after a period of war, farm products seem to suffer in a greater degree from the post-war correction of price. Their production is stimulated during war either by price fixing or by the

natural advance of prices, because their supply is inelastic ; hence the relative fall in agricultural prices. In any case exchange is not responsible for these results, nor is inflation, as we shall soon see, any remedy for this state of things. The evil of this swing of relative prices—for so it is—is to some extent mitigated by the large and successive harvests which we have had.

As we have seen, the United States has been the first country to feel the stress of the world-conditions which are hampering the farmer. The experience of that country in the matter and the opinion of its leading economists on the subject, are of great value to us under the conditions prevailing in India. The influence of the exchange and currency conditions on the relative prices of agricultural products has naturally attracted much attention there. Mr. R. J. McFall of the Massachusetts Agricultural College, writing in the *Annals of American Academy* in 1925, argues that, to the extent to which alterations of exchange are due to monetary inflation or deflation and have been thoroughly reflected in a country's prices, the influence of foreign exchange is negligible. What is of importance is this: "Any country that competes with the United States, in the sale of farm products and has materially lower prices for those products than our prices, by reason of either the exchange rate or the domestic price level, has the advantage over us in making sales." Consequently Mr. McFall desires the reduction of the price-level in the United States. This dictum should furnish matter for thought to those in India who are apprehensive of a fall of world prices, but who would prepare for it with surprising inconsistency by raising prices in India.

We might with advantage quote the opinions of the same economic authority as regards the great importance of the relative prices of his products to the farmer. In another article in the same number of the *Annals*, Mr. McFall observes that "to the farmer, the general price level is less important than that his products exchange on a par with others." Now it must be remembered that the general rate of exchange can only mo-

dify and affect the *general* price level in a country; it can have little influence on the relative prices. This important consideration indicates the limits of the effect of any manipulation of exchange on the fortunes of the agriculturist. No doubt, if Mr. McFall had been living in India, he would have pointed out another aspect of the comparative inefficiency of any exchange policy on the agriculturist's fortunes; for, where there are such gigantic fluctuations from year to year in the prices of crops like jute and cotton, any possible effects of exchange on prices sink into comparative insignificance.

AN EXAMINATION OF THE PROPOSALS FOR A GOLD-CURRENCY IN INDIA

Diversity of views on gold currency

It would appear at first sight that the enlightened public opinion in India was overwhelmingly in favour of a gold currency. But when we come to analyse and classify the views put forward, we find that the same phrase—"gold currency" has been made to cover a wide diversity of views. The large school of Indian economists and even many of the commercial circles are too well acquainted with the progress of monetary theory and practice in the world to advocate a gold currency as generally understood. Drawn, as they are in one direction, by the traditional policy laid down for them decades ago, and in the opposite direction by their scientific studies and their observation of the economic facts and tendencies of their own day, their actual position becomes a series of varying individual compromises in which the emphasis of opinion is very variously distributed, but it is rarely indeed that the essentials of gold circulation are insisted on. Thus we have eminent witnesses who are anxious not so much for the circulation of gold coins as of gold notes. No one has advocated the issue of a gold coin of such a small value as to ensure its use in daily transactions and in general circulation; while researches into the monetary history of India have shown that a very large portion of the former gold currency consisted of the *fanam* and other small coins. Almost all witnesses who asked for a gold currency expressed a strong desire and hope that gold coins would not circulate strongly. They expressly want "some circulation of gold but not a large circulation because the people of India are poor and the masses would not be able to get any amount of gold; it would be mainly the middle classes that would be able to get it". Hardly any one expressed a desire to force gold into circulation; many stated expressly that they would not even "encourage the

circulation of gold". In fact, if most of the witnesses were certain that the introduction of a gold currency would result in anything but a golden fringe to our currency, they would hardly press for it with any consistency.

Futility Of A Slender Gold Currency

These are discreet views—to say the least—behind which we can trace the struggle between the traditional desire for the yellow metal and the reaction of the greatly changed aspect of monetary theory and practice. But will not such lukewarm advocacy involve us in a lot of expense and yet fail in achieving its professed objects? If, indeed, the gold coin is going to form so small a portion of our currency, how is it going to fulfil the important functions which are claimed for it? Unless there are very substantial amounts of gold currency in circulation, how is the anticipated psychological revolution to be brought about which will cause the hoarding habit to disappear? We quite agree with the view that has been put forward that "once a thing becomes common, people do not want to hoard it". Hence to weaken the hoarding habit we must make gold coin available commonly and freely to the people and not merely show it to them occasionally. How is a coin, which does not circulate substantially and which is, besides, too large for daily transactions in the country, to inspire that general confidence in the currency system which has been claimed for it? How are the people to be weaned from their age-long attachment to silver unless we encourage the circulation of gold markedly? Have not Dr. Cannan and Dr. Gregory in England and Dr. Ambedkar of Bombay assured us that the proper way to introduce gold currency is to suspend all additional issues of silver coin and to stop all additional issues of notes? Thus, in the opinion of these eminent experts, we have not only to "encourage" the circulation but also to "force it in" by starving other forms of currency—which implies that we shall have to push into circulation a substantial amount. It is all very well for our critics to hope and desire that India will absorb only a little gold currency. On the one hand, if only a little gold

is absorbed, the great expectations based on such currency cannot be fulfilled; on the other hand, we cannot base currency systems on pious hopes and good wishes; nor can we—town-bred economists and industrialists—safely dogmatize about the psychology of a vast rural continent and forecast exactly what these great rural masses will do when particularly tempting opportunities of hoarding are placed in their way.

Arguments For Gold Currency

It is advisable to examine successively the leading arguments put forward in favour of a gold currency.

(1) The general argument advanced is that the rupee has forfeited the public confidence while the institution of a gold currency will secure such confidence in the monetary system. As a matter of fact, however, so great is the public confidence in and liking for the rupee that most even of the advocates of gold currency recoil in fear from the first step proposed in the dethronement of the rupee—viz. the limitation of its legal tender quality. Many call it a heroic step; others term it an impracticable proposal. No less an advocate of gold currency than Mr. Madon frankly and sincerely admits it. "In view of the enormous amount that must now be in circulation and in hoards, it is not practicable to consider any limitation at this stage. I would, therefore, allow the existing rupees to continue to be full legal tender for any amount as at present. When the gold currency gets fully established in the minds of the public as the real money of India, the position of the rupee can be reconsidered." This constitutes a very fair and frank admission that the rupee commands such public confidence that it is largely hoarded and that it is dangerous to try to shake this confidence prematurely. It implies further that it will take a lot of time to transfer such confidence to the gold coin. Nor can any cheap and half-hearted attempts at a slender circulation of gold secure such confidence.

(2) Another contention has been put forward to the effect that the gold standard is more automatic than the present system. To those who argue this it is well to remind that under gold standard, as at present understood, the prices will be "managed prices" and that the prices will be managed from abroad—perhaps from the country which possesses the largest available supply of gold; or there might be very likely international co-ordination to avoid a scramble and any fluctuation of prices which might be considered undue. For this latter purpose the credit policies of different countries might have to be managed. In any event, in the future, the gold standard and prices in the gold standard countries will be "managed" in a very thorough sense of the word.

But, further, while we are on this point, it is relevant to quote prof. Kemmerer's view that "the pure Gold Exchange standard is almost as automatic in its functioning as is the gold standard with a gold currency"; and it can be added that the proposed Gold Bullion Standard, worked by a central bank is even more automatic than the pure Gold Exchange standard, and as automatic as the gold standard and gold currency for there is no administrative discretion, as regards the working of the standard, no confusion of monetary and fiscal objectives in the sale of exchange and in the detailed management of the system.

(3) Little addition is made to the real arguments for gold currency by the conjuring up of a pseudo-historical law of monetary evolution by which it is implied that nations cannot pass from silver currency to paper currency which is the final goal, without going through an intermediate and educative stage of gold currency. No proof has ever been offered of the existence of such a law of monetary progress: and in various provinces of India the note is already very popular. But, in any case, such an educational stage, if it is to be of any value in educating the backward masses, should see a very thorough saturation of the country with gold currency, and will naturally prove a very costly one.

Difficulties In The Working Of A Gold Standard In India

It can be easily shown that even with a full gold standard India cannot escape some of the main difficulties of the present system. The main causes of these difficulties are two—hoarding and the great and abrupt demands for currency made by our foreign trade in favourable seasons. The loudly proclaimed difficulties of Gold Exchange Standard are due to these causes chiefly, and the trouble will continue with full gold standard. Whenever there is a good export season, gold will be imported largely and the country's currency will expand not in proportion to the demands of the country's trade as a whole but in proportion to the demands of its foreign trade which are abrupt and large. Again, the habit of hoarding opposes another obstacle in the way of the automatic action of any monetary system— for part of the currency goes out of circulation and will thus not exert its expected influence on prices. A third factor also exists which renders the contraction of currency difficult in India viz. the sensitiveness of our money markets. With these three factors any monetary system whatever is bound to work in India to some extent erratically.

Cost Of A Gold Currency

In some quarters the cost of introducing gold currency into a continent like India has been regarded with a light-hearted spirit of over-confidence which is quite out of place. It is thus assumed by some that by utilising our gold reserves and through the action of our usually favourable balance of trade we shall, without more cost, come into possession of a gold currency. But this facile statement misses the most important factors in the cost of the introduction of a gold currency:

(1) As soon as the legal tender quality of the rupee is touched, there will be a great fall in the value of the silver hoarded by the country or used as ornaments. The price

of silver might easily fall to 24d. or even lower; and the fall in the value of this silver treasure which has been accumulated for centuries will amount to hundreds of crores of rupees.

(2) Eminent advocates of a gold currency like professors Cannan, Gregory and Ambedkar have justly argued that the only practical way of supplanting silver by a gold currency is by ceasing to coin additional rupees and by depriving silver of the legal tender quality; they further advocate that no additional issues of notes should be made. Their argument is unassailable—that as long as the masses get their accustomed currency they are not likely to take to new money. But their proposal avowedly is to starve the Indian currency in order to make room for gold coins. Dr. Gregory avowed this before the Commission. What the cost of such a process of preliminary curtailment of currency is likely to be in the shape of very high discount rates over a long period, I leave our industrialists and business men, who champion gold currency, to guess.

(3) It is obvious that, before undertaking such a great national policy, our preparation of resources should be fully adequate before we change our monetary system. We cannot afford to drop the scheme once we have taken it up; for, we should have ruined our present monetary system and squandered its reserves and would have failed to attain the Gold Currency and Standard. To avoid such a double failure a careful estimate of the requisite resources has to be made. The Finance Department tried to make an estimate before the Commission; their rather optimistic calculation put the required resources at 103 millions. But eminent experts like Professors Cassel, Hollander, and Sprague showed that the estimate was much under the mark. Insufficient allowance had been made for several important factors—much of the gold issued might be hoarded; large amounts of silver might be thrown on the market in order to acquire gold; and a large quantity of notes might be presented to secure gold. The conclusion was that the extra demand for gold caused by the gold currency scheme

could easily attain a figure several times higher than that assumed by the officers of the Finance Department.

An Untimely Proposal

It would be difficult to imagine a more inopportune moment than the present for adopting a gold currency for India, and even for taking any step in that direction. America has warned us in the plainest terms that none of its gold supply will be made available for the object proposed. In London we were told that "the Treasury or the Bank of England would be absolutely justified in making difficulties about such a loan". The bottom has dropped out of the silver market at the very suspicion of touching the legal tender quality of the rupee, which has already caused substantial loss to Indian interests. World-renowned and absolutely impartial authorities like Prof. Cassel assure us that the present moment is one in which every effort should be made to economise the use of gold; and that, failing such efforts towards systematic economy in the use of gold, we shall inevitably approach a period of falling prices and slackened economic progress. This general depression of the economic life of the countries to which India sends her exports must infallibly react on her own prosperity. Any substantial fall of her increasing balance of exports would undoubtedly injure the financial system, the currency and the general economic life of India.

In conclusion, I would draw attention to some remarks by Mr. Keynes on the subject in hand. "We are not at the end of currency discussions but at the beginning of them. The future currency of the world is going to be determined not by what happened in the last two or three years, but by what is going to happen in the next 10 years. It is impossible to say what the experience of the countries which are going over to the gold standard is going to be. I think that India will be well advised to hold her hand until some experience has been gained."

THE CURRENCY REPORTS OF 1898 & 1926

A Close And Instructive Parallel

In the growing literature of the present Exchange controversy it is indeed surprising to find that the critics of the Currency Report of 1926 refer so frequently and fondly to the Fowler Committee's Report: for—excepting in the matter of gold currency—the Fowler Committee has expressly overruled every plea and answered every argument that the opponents of the 1s. 6d. ratio have put forward in our days. So similar were the exchange and currency problems of 1898 and 1926-27, so high is the authority of the members on and witnesses who appeared before the Fowler Committee, and so varied and rich have been the experience and results of the policy of 1898, that we might draw valuable lessons from the earlier conjuncture to clear up the issues of our own days.

It is remarkable, in the first place, that every single argument which the Fowler Report employed on behalf of the 1s. 4d. rupee can be used to-day, without the alteration of a phrase or a word, to support the 1s. 4d. ratio. Indeed, the arguments of 1898 gain in weight when applied to the circumstances of our own day. Thus the main argument on behalf of the 1s. 4d. ratio was that "the rate of 1s. 4d. is that of the present day; prices in India may be assumed to have adjusted themselves to it, and the adoption of materially lower rate at the present time would cause a distinct and, in our opinion, a mischievous disturbance of trade and business". (Fowler Report, para 65). One has only to compare this with the Currency Report of 1926, paras 176-188 and note that while using that identical argument the Royal Commission has proved the same point with a much greater recourse to statistical weapons of precision as was to be expected in the days of Keynes and Cassel.

Another argument employed by the Fowler Committee in favour of the 1s. 4d. ratio was that the ratio was found in

the year 1898-99 quite compatible with a volume of the export trade which exceeded that of all past years (Paragraph 64). Is it necessary to refer to the much larger series of record balances in favour of India in recent years under the 1s. 6d. ratio ?

Nor did the Fowler Committee fail to notice that "a rise in prices which expresses only the depreciation of the currency is no gain to the community as a whole, and although the fixing of a lower denomination in sterling for the rupee might for a time give some advantage to producers, this would be at the expense of every holder of a rupee, or debt or security for a fixed amount of rupees." (para 66).

Again, as in 1926, the dissenting minutes of 1898 raised the pleas that in the matter of exchange "the status quo had not been arrived at in a natural way", also that "to arrive at a rate in this manner and then to point to the accomplished fact as disposing of any question of its propriety is not convincing." Further they were unable to see "where the prices and wages adjustment were to come from". The lapse of a little time showed them where, and silenced these critics effectually.

Sir Purshottamdas and his friends make light of the effect of a reversion to the 1s. 4d. ratio on the public finances. On this point the views which Sir R. Giffen and Prof. Marshall put forward before the Fowler Committee are very instructive. Thus, Sir R. Giffen argued that if the lower ratio (of 1s. 2d. in those days) was reverted to, new taxation would be necessary to balance the budget. So also he argued in favour of raising the railway rates in case a lower exchange ratio was fixed. These views of those eminent economists agree entirely with those put forward by Mr. McWatters and others before the Commission of 1926.

The "Natural" Ratio.

What is a "natural ratio"? The whole literature of classical economics might be vainly searched for the use of such an

expression. But in 1898, and in 1922 and in 1926-27 the advocates of the lower exchange in India believed that they had found it. *Eureka*. Only in 1898 it was 1s. 2d. as opposed to 1s. 4d. which is in our days "the natural ratio" but was then condemned as "a forced ratio". However, in 1922 the late Sir Vithaldas Thakersey strongly asserted that 1s. 6d. was the natural ratio; this was the second time when we meet with the idea of a natural ratio. In 1926-27, however, 1s. 4d. has been extolled as the natural ratio and indeed a Calcutta publicist has gone further and has told us that it is "the only natural ratio". It seems then that the "natural ratio" is something fluctuating and dynamic—it is 1s. 2d. if the alternative proposed is 1s. 4d.; it is 1s. 6d. if a higher ratio is in sight; but it is 1s. 4d. if the ratio of 1s. 6d. is in prospect. Can it be that the lower ratio is always the natural ratio?

The interests of Indian producers in general and of agriculturists in particular were kept as much to the fore in 1898 as in 1926. All the arguments with which we have been familiarized of late as regards the increase of the burden of the agriculturists' debt and interest thereon and of the land revenue under a higher exchange were brought forward in 1898 also. History, however, shows us that the higher ratio—as it then was—of 1s. 4d. was quite compatible with a great increase of India's export trade in food-grains. It was also firmly believed in those days by many that numerous industries of India were in danger of ruin under the regime of 1s. 4d.—notably tea and textiles. These gloomy forebodings were soon dispelled by the march of events.

The industrialists of those days used to put the potential effect of a lower exchange (and the resultant inflation) on the interests of labour with a praiseworthy frankness and brevity. Thus Mr. S. A. Ralli observed: "If you have a tea-garden, and the exchange, instead of being 1s. 4d., is 1s. 1d. then for the wages you pay in India you make a profit of 2d. per rupee". How crude it sounds now!

The success of the policy of 1898 in raising and stabilising the ratio has been undoubted; and yet the case for 1s. 4d. was much less strong in those days than the case for 1s. 6d. in our days. We must remember that in 1898 the 1s. 4d. ratio was a very bold experiment. The constantly rising balance of trade to which we are now accustomed did not then exist to give confidence in the maintainability of the ratio. Nor did our reserves hold such resources as we have now to fall back upon. Nor was there in those days a surplus stock of gold as we have now in America to be thrown into the scale in case of an important decline of world prices. In fact, the policy recommended by the Report of 1926 has all the arguments of the Report of 1898 behind it and much brighter prospects before it. It is the task of economic history and retrospect to give us a true perspective of the facts of the present-day situation, and thus to fulfil the poet's wish—

O wad some Pow'r the giftee gie us
To see oursels as others see us!

REPORT OF THE ROYAL COMMISSION ON
INDIAN CURRENCY AND FINANCE
(1925-26).

The Real Test Of The Value Of The Report.

It is a difficult and a delicate task to attempt to appraise the merits of a work in the composition of which one has had a share however humble. I venture to suggest, however, that the true criterion of the merits of the Report of the Royal Currency Commission consists in the large number of long-standing controversies, criticisms and allegations that would be set at rest, silenced and made obsolete, were the recommendations contained in that Report to be adopted. We have an extensive literature of the criticisms of the monetary policy of the country, and almost all of it would retain only a historical interest, were the proposals in the Report carried out. The name of such criticisms is legion; but I would select a few of the leading ones to illustrate my remark. Thus the perennial complaints of the former practice as regards remittances by Government and the stream of controversy as regards the overlapping between the Currency Reserves with the balances of the Secretary of State would be a matter of the past. Once the Report is adopted, no one could even suggest that "immense sums are being transferred from India to London" needlessly, and that the Indian money market was deprived of the use of funds to which it was legitimately entitled. We shall no more suffer from the difficulties caused by the distribution of our resources in different reserves, and from misapprehension in the matter of the separation and location of the two great reserves. The difficulties which were due to the fact that the control of currency and credit were in different hands will have been over-come; and the whole currency, exchange and banking system of India will have been placed upon its true practical and scientific pivot in the shape of the Reserve Bank. The earlier Currency Commissions did not possess similar

* Speech delivered before the Indian Economic Conference of 1927

opportunities for a radical and scientific reconstruction of the Indian monetary system. They were cramped by their restricted terms of reference. The Fowler Committee could not possibly foresee that rich and varied evolution of monetary theory and practice which has taken place in the first quarter of the present century. The Chamberlain Commission, again, was too much pre-occupied with the particular dangers manifested in the crisis of 1907-8; and the war followed so closely upon its report that its recommendations never really had the chance of being carried out. Above all, there was no great Central Bank in India in those days to serve as the base of currency reform.

A Land-mark In Economic Liberalism

The proper way to appreciate the merits of the Currency Report is to investigate its true place in the economic history of India. I claim that regarded from one point of view, it is a most important step in the evolution of economic autonomy of India, while it is, at the same time, a great chapter in the long and honourable history of Economic Liberalism. We little realise the great pace at which our economic history has gone forward in the post-war decade. The virtual grant of fiscal and tariff autonomy, labour legislation of a liberal character and a series of budgetary and financial reforms have all followed each other at a very rapid pace, and the future historian will occupy himself a great deal with their importance. It is probable that he will compare the pace of the economic reforms we are witnessing with the momentum at which economic liberalism went forward in England in the days of Peel and Gladstone. But, even in the present epoch of economic progress in India the Report of Currency Commission will, if its recommendations be adopted, form a very conspicuous feature, for, the transfer of government functions, as proposed by it, is likely to be epoch-making indeed. The Government will cease to operate directly in the Exchange market and will hand over the remittance operations to a reserve bank.

The balances of the Government of India and of the Secretary of State outside India are also to be given up to the same bank. The Government will also divest itself of its right of issuing notes. As the Honourable Sir Basil Blackett has put it "the whole burden of the Currency Commission was to recommend a transfer to India of the control of India's finances under the auspices of a Reserve Bank independent of Government control." The principle is fully accepted, and the strongest precautions have been taken to keep the Bank free from all political pressure. To secure that object, it has been provided that a predominant majority of the members of the Local as well as Central Boards of the Bank should derive their mandate from the shareholder of the Bank by election. The critics of the Report might very pertinently be asked to point out another example from economic history of such a general transfer of so many important functions by a Government at one stroke into popular control. The credit for such a step should be given in a special measure to the authors of the Finance Department Memoranda placed before the Currency Commission. But the momentum thus imparted has been carried forward fully by the Report and hence, as has been said before, many of the chapters of that Report form also notable chapters in the growth and development of Economic Liberalism.

Inconsistencies Of Its Critics.

I have no time in this meeting to defend the Report against the criticisms that have been levelled against it. But I can in a brief space present a small list of the inconsistencies which might be found in the writings and speeches of these critics. A body of economic experts is the best judge of such inconsistencies in reasoning. I reserve the right to add to the list later on, as the flood of criticism broadens:—

(1) The main argument of the Report's critics consists of two inconsistent propositions. They assert, on one hand, that the Government has resorted to a most drastic

deflation; on the other hand, they assert that this deflation has had very little effect on prices, and consequently there has been only a small reduction of prices and a very inadequate adjustment of these prices. The economists assembled here will no doubt see the difficulty and dilemma into which the hasty critics of the Report have worked themselves. To exaggerate the deflation and yet to deny to it any corresponding effect on prices is inconsistent economic reasoning. Those who desire to know the alleged extent of the deflation are referred to Mr. Madon's well-known work on "Exchange Fallacies Exposed, Part I."

(2) The critics argue that the high exchange has injured the agriculturist because he has to pay his debts and his land-revenue in an *appreciated rupee*. In the same breath, however, they deny that prices have adjusted themselves to the exchange. But if the rupee has, according to them, appreciated by 12½ per cent. is that not the same thing as to say that rupee prices have also adjusted themselves to the rise of Exchange by 12½ per cent. from 1s. 4d. to 1s. 6d.?

(3) On the one hand, our critics would introduce a gold currency, on the other hand they express apprehensions of the fall in world prices. Will not extra demands by India on the world's gold supply for establishing a gold currency, contribute materially to a fall of world prices?

(4) On the one hand they assert most emphatically that the Indian agriculturist has been ruined by the high exchange, and that the most monstrous financial burdens have been laid on him; on the other hand, they fail to produce any statistical evidence of such a state of things. How about the 70,000 flourishing co-operative societies working all over India and increasing in prosperity under the 1s. 6d. regime along with their central banks and provincial banks?

(5) According to our critics, the higher exchange has dealt a great blow to our producers and exporters; and has

vastly facilitated import operations. Yet under the present ratio is it not a fact that the export trade has progressed much better than the import trade ?

(6) As to the extent of adjustment, no consistent position has been taken up ; indeed the inconsistency is most glaring and conspicuous. It is not merely a case of doctors disagreeing ; for here the same doctor repeatedly disagrees with himself. In the Dissenting Minute Sir Purushottamdas is of opinion that the adjustment of prices is only 30 points against 50 i. e. 60 per cent (paragraph 95). But in an article in the *Times of India* of the 27th November, 1926, he admits that it is above 73 per cent. (i. e. 26 points out of 35. 5 points). However, in the same article he suggests later that the adjustment is less than 50 per cent, for he observes : "Even if it is granted that the disturbance involved in the former (i. e. in a reversion to 1s. 4d.) would be as great as the disturbance still to come with an adoption of 1s. 6d. ratio which is the utmost that could be conceded etc." so that in one place, the adjustment is said to be 60 per cent : in a second place it is represented as 73 per cent : and on a third occasion as less than 50 per cent. Which of these three estimates is to be accepted ?

(7) There is another inconsistency which is the property of our critics. In paragraphs 92 and 94 of the minute of dissent as well as in the above-mentioned article in the *Times of India*, the world prices are represented as acting on Indian prices at once and by their entire and full extent. Thus, any rise and fall of foreign prices is supposed to act at once and to its full 100 per cent measure on *all* Indian prices (not merely on the prices of our exports) : at the same time, it is the whole case of Sir Purushottamdas that the adjustment of Indian prices to the foreign exchange is extremely slow. How is this strange behaviour of prices to be explained, and what sort of economic theory lies behind this striking distinction between the two kinds of adjustment ?

A REPLY TO MR. BIRLA To the Editor of the "Statesman."

SIR.—Permit me to reply to Mr. Birla's remarks (in your issue of the 24th instant) regarding my interview.

(1) The Reports on co-operation, to which I referred do not prove merely that "the agriculturist has not been ruined," as Mr. Birla says. They go a good deal further, and show that he is in a state of progressive prosperity. This disproves the assertion so often made that the farmer has been ruined (see Mr. Madon's pamphlet No. 2 published by the Indian Currency League.) I might point out that Mr. Birla is shifting his ground in the letter where he says, "let a bad year come and the Professor will see, etc." The Currency League assures us that the Indian cultivator has already been ruined; but Mr. Birla would now ask us to wait until a bad year supervenes for the accomplishment of such ruin.

(2) Mr. Birla observes: "But the most amazing portion of his interview lies in the statement that because the higher prices in comparison with the pre-war level have led to a large reduction in the burden of the debtor class the process should be reversed." But, surely, there is a limit to the process of any class gaining at the expense of its creditors, and it cannot complain of any partial and incidental readjustment. Nor is Mr. Birla right in stating that the cultivator's gain was due to "natural circumstances created by God." The rise of prices was due not to any divine ordinance but to the inflation of currency during the War. No class has a vested right in any advantage resulting from an abnormal price-fluctuation.

(3) Mr. Birla asks "what remedy will the professor suggest if the world prices fall further? If the world prices are indeed going to fall, how would a currency inflation protect our agriculturist against it? How could we prevent the readjustment of the cultivator's costs of living and production to such inflation? Who ever heard of a local currency inflation as the remedy for a fall of world prices?"

Yours, etc.

J. C. COYAJEE.

Mr. G. Birla having attempted to meet the arguments in my interview to the *Statesman*, the above letter was written to meet his contentions.

A REPLY TO SIR PURUSHOTTAMDAS THAKURDAS

To the Editor of the "Statesman."

Sir,—I have read with great interest Sir Purushottamdas Thakurdas's letter in your columns to-day. I submit that, generally speaking, a Commission's Report is not the place for detailed and lengthy polemics against the authors of dissenting minutes. It might be noted in this connexion that neither the Fowler Committee's Report nor the Chamberlain Report contains answers *in extenso* to notes of dissent. Nor can any criticism be "belated" provided it appears before the decision is taken by the Legislature.

I wish my treatment of the subject was as original as Sir Purushottamdas would make it out to be. As a matter of fact, it is only the application of elementary economic theory and ordinary sense of justice to the problem in hand. Treating of the question of equity between the debtor and the creditor I pointed out that the debtor gained for a time incidentally, because of inflation and the consequent rise of prices. The inflation during the war was not intended to provide any advantage for the debtor class; the gain was only an incidental effect. Similarly the raising of exchange and the resulting adjustment of prices reversed the former process partially, and incidentally deprived the debtor of some of his unearned gain. In this case, too, the raising of exchange was not intended to deprive the debtor (agriculturist or other) of his windfall. My main proposition is that the debtor has no right to complain when an incidental advantage, for which he has paid nothing, is taken away wholly or partly. I confidently affirm *the principle that no class has any vested right in an incidental*

* Sir Purushottamdas having attempted to meet the arguments in my interview to the "Statesman", the above letter was published to meet his contention.

advantage which it might have obtained as the result of *ice^d fluctuations.* Sir Purushottamdas refers to the case of other countries. Now, in almost every other country prices went up, at first, during the last decade, as the result of inflation during war; and they were brought down later by the process of deflation. The debtor gained at first in the foreign countries also but later on he lost this gain through deflation. In no country did the Government raise prices to benefit the debtor, nor did they lower prices to benefit the creditor. Sir Purushottamdas's criticism would have been relevant if I had argued that exchange should be raised only to help the creditors.

Sir Purushottamdas has expressed a hope that I shall stand by my arguments and exposition. I shall take good care not to disappoint such an energetic controversialist—Yours, etc.,

J. C. COYAJEE.

Calcutta, Jan. 18.

INDIAN CURRENCY REFORM

(BEING A REVIEW OF THE REPORT OF THE ROYAL
COMMISSION ON INDIAN CURRENCY AND FINANCE, 1926)

BRIJ NARAIN,
PROFESSOR OF ECONOMICS,
Sanatana Dharma College, Lahore.

Messrs. SHAMSHER SINGH & Co.,
KATCHERI ROAD, LAHORE.

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PREFACE.

I have used in this book an article on *Exchange and Prices in India, 1873-1924*, which I contributed to the *Weltwirtschaftliches Archiv*, Kiel, (April 1926), and articles on the Currency Report contributed to the *People* and the *Tribune* of Lahore and the *Hindustan Times* of Delhi.

The chief feature of the Currency Bill, which is under consideration, is the proposal to fix the exchange value of the rupee at 1s. 6d. The Currency Commission have recommended the stabilization of exchange at this rate on the ground that Indian prices have become adjusted to the 1s. 6d. rate. The Government have accepted this view.

I have examined in Part II of this book the statistical material bearing on this question, and find that the downward movement of the rupee price level has neither been rapid nor violent, and that the fall in prices which has taken place is in sympathy with the fall in European gold prices.

This is the conclusion suggested by such figures of Indian price movements as are available. But, in view of the importance of the question, it is desirable that a more exhaustive study of Indian prices should be made, before exchange is stabilized at 1s. 6d. or any other rate. For reasons which I have stated in Part II, the examination of the question by the Currency Commission is of little value.

The present writer is an advocate of the genuine

gold standard for India, with gold actually in circulation. Academic and commercial opinion in India is decidedly in favour of the gold currency standard, and so far as "the unexpressed opinions of 80 or 90 per cent of the population" are concerned, the steady increase in the absorption of sovereigns into circulation from 1900 to 1914 conclusively shows that the masses want a gold currency. This is "the most solid argument" in favour of a gold currency. The gold bullion standard of the Currency Commission will never be popular as it ignores the Indian demand for gold coin circulation.

It is proposed that the notes issued by the Reserve Bank should not be convertible by law into silver rupees. The proposal is revolutionary and dangerous. It will give India a system of inconvertible paper money, which will sooner or later lead to disaster. The convertibility of notes into gold in amounts not less than 400 fine ounces, under conditions which make it unprofitable to demand gold except for export, is, from the point of view the general public, no convertibility at all.

The establishment of the genuine gold standard in India will be a work of time and labour, but this is "the ideal end" towards which India should work. The Currency Commission, under the influence of foreign witnesses, have condemned the scheme for the establishment of the gold standard in India prepared by the Finance Department. But the scheme is not inherently impracticable.

The reader's attention is specially invited to Chapter IV (Part I) in which certain passages from the volumes of Evidence and the Currency Report are given in parallel columns. It will perhaps be said that the

report of a Commission is necessarily based on the evidence given before the Commission. That is so, but I have not yet seen the report of any Committee or Commission in which whole passages were taken, word for word, without acknowledgment, from the evidence of certain witnesses, *without any examination or analysis of the opinions, estimates or arguments of the witnesses concerned*. The disadvantages of plagiarism as a method of writing a report are shown by the reference in the Currency Report to China. If this is not cooking evidence, I do not know what is. The whole thing is immoral, and I hope that some public-spirited member of the Legislative Assembly will insist on an explanation.

Lahore, Oct. 15, 1926.

BRIJ NARAIN.

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PART I

THE GOLD BULLION STANDARD

I

MAIN RECOMMENDATIONS.

The Currency Commission have recommended the adoption by India of the gold bullion standard. The gold exchange standard is definitely condemned by the Commission as unsatisfactory. We have the important admission that the gold exchange standard does not work automatically, and that it is not elastic. "The automatic working of the exchange standard," says the Report (para. 16), "is thus not adequately provided for in India, and never has been" (*italics mine*). The Report refers to "the absence of contraction on occasions when the currency authority has had to sell sterling exchange." In 1920 the consequences of this were "disastrous." And the Report adds.

"There must ever be danger of such disaster under a system which does not automatically enforce contraction of internal currency concurrently with the depletion of Reserves."

These remarks would, undoubtedly be read with interest by certain official apologists** who, like Mr. Findlay Shirras, regard the gold exchange system as an "improved gold standard," as "a system of money which has become and must become increasingly popular," and who are lost in admiration of "the beautiful elasticity of our currency system."*

** The Indian currency system of to-day is, however, quite as automatic as it was previous to the closing of the Mints to the free coinage of silver" (*Datta's Report on Prices*, para. 228).

The Chamberlain Commission of 1914 denied that the gold exchange system gave India "an artificial and managed currency." "It is not in fact possible for the Government of India," says the Report of the Chamberlain Commission (para. 66), "to manipulate the currency, and they cannot add to the active circulation of the currency except in response to public demand."

**Indian Finance and Banking*, 1920, p. 37.

The main recommendations of the Currency Commission may briefly be summarised as follows:—

Under the gold bullion standard recommended by the Commission the currency will consist of silver rupees and notes, which will be directly convertible into gold. The sovereign and the half sovereign will cease to be legal tender, and gold will not circulate as money.

The control of currency and credit is to be entrusted to a new organisation, called the Reserve Bank. The bank will be given the sole right of note issue for a period of (say) 25 years. Not later than five years from the date of the Bank's charter becoming operative, Government notes will cease to be legal tender except at Government Treasuries.

An obligation will be imposed by statute on the Bank to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee (1s. 6d.) but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold is required.

The paper currency will cease to be convertible by law into silver coin.

For a fuller summary of the recommendations the reader should see pages 86—88 of the Report. But the very brief summary given above fairly indicates the nature of the currency system which has been recommended for adoption.

The proposed system differs from the old in several respects. Firstly, we have the creation of a new organisation to control the credit and currency policy of the country. Under the old system the Government controlled the currency while the credit situation was controlled by the Imperial Bank. Secondly, the Paper Currency and Gold Standard Reserves are to be amalgamated. Thirdly, and this is important, a statutory obligation is to be imposed on the Reserve Bank to buy and sell gold. Under the old system the Government did, as a matter of fact, sell Reverse bills when the exchange tended to fall below specie point. It will be remembered that the Chamberlain Commission recommended that "The Government should definitely undertake to sell bills in India on London at the rate of 1s. 3 29/32d. per rupee whenever called upon to do so" (para. 101). The Government accepted

this recommendation, but it did not impose upon the Government a statutory obligation to give gold for export or sell gold exchange.

II CONVERTIBILITY.

The chief feature of the gold bullion standard is the convertibility of token money directly into gold bullion for all purposes. The Currency Commissioners attach great importance to it. Under the old system paper money was convertible by law only into silver rupees, which are themselves token coins. By making notes convertible by law into gold bars for all purposes, we are told, "a more solid right of convertibility is attached to them than they have ever had since silver ceased to be a reliable standard of value" (para. 69). Para. 61 of the Report states:

"For the purposes of India this standard (gold bullion standard) fulfils the essential condition, that it should be not stable only, but simple and certain. It provides the token currency with a right of convertibility that is intelligible to the uninstructed, and with a backing that is tangible and visible."

This recommendation of the Currency Commission has been misunderstood in certain quarters. It has been thought that under the gold bullion standard token money will be freely convertible into gold, not merely for export, but for internal purposes. It was easy to make this mistake, for the "uninstructed" could not be expected to see the "tangible and visible" backing of the token currency, unless token money was freely convertible into gold for internal use.

In *theory*, token money, under the gold bullion standard, will be convertible into gold for *all* purposes; in *practice* it will be convertible into gold only for export.

In para. 64 of the Report we are told that gold will not be sold by the currency authority cheaper than the market rate. The wholesale bullion market which exists now is not to be destroyed. If the currency authority were compelled to sell gold at a price exactly corresponding to the par value of the rupee (*i.e.*, cheaper than the market rate which includes the cost of import), the consequences will be serious.

"Apart from destroying the wholesale bullion market," says the Report, "the currency authority would inevitably become involved in the performance of a task which does not properly belong to it, (*i.e.*, supplying

gold to the public for non-monetary purposes). Its primary duty of maintaining the monetary unit at parity with gold (*i.e.*, maintenance of exchange at 1s. 6d.) would be made far more difficult....."

Schedule I is even more explicit:

"The reserves," it says, "exist to assure the maintenance at parity with gold of the purchasing power of the monetary unit, *i.e.*, to meet purely monetary needs (*i.e.*, to maintain the external value of the currency). It is evident that if they can be drawn upon in the ordinary course to satisfy non-monetary purposes to anything but a minor extent, the Bank's primary task, *viz* to maintain the external value of the currency, will be jeopardised."

Now suppose that a large amount of gold was wanted for internal use, and the gold reserves of the Bank began to disappear. To meet the loss of reserves owing to an internal drain the Bank would be forced to restrict credit. This, says Schedule I, "would have highly injurious reactions on the internal economy of India, and should consequently be avoided." Therefore,

"It is required so to frame the Bank's obligation to sell gold as to make it unprofitable for gold to be bought from it except in circumstances in which it would be profitable to do so for purely monetary purposes" (*i.e.*, for export).

In a letter dated the 18th August, addressed to the Secretary of the Government of India, Finance Department, the Secretary of the Indian Chamber of Commerce, Calcutta, thus commented on the proposed selling rates for gold.

"Turning to the obligation undertaken in Section 5 of the (Currency) Bill, that the Government shall sell gold at the rate of Rs. 21-3-10 per tola, it is obvious that the Government do not intend to sell any gold to the public except when the exchange is above the gold point of 1s. 6d. rate. With such a position in the market the public are certain to sell to the Government rather than to buy from them" (para. 3)..

Why? The explanation is that the gold equivalent of the rupee is 1s. 6d., and at this rate the price in rupees of a tola of fine gold is Rs. 21-3-10. When the rate of exchange is 1s. 6 3/16d. (upper gold point) or more, the equivalent in rupees of a tola of fine gold is less than Rs. 21-3-10. The Government's offer to sell gold at Rs. 21-3-10 per tola will remain ineffective when the rate of exchange is at or above the upper gold point.

It will be profitable to buy gold from the Government (or Reserve Bank) at this price only when the rate of exchange is below the upper gold point.

When the exchange is below the upper gold point, the selling rate for gold will not be Rs. 21-3-10, but more. The Reserve Bank shall sell gold in that case for delivery at its office at

Bombay or London at notified prices, and these prices will be so fixed as to free the Bank in normal circumstances from the task of supplying gold for non-monetary purposes.

"The purely monetary purposes" referred to in Schedule I relate to gold for export, and not to gold given for hoarding or for making ornaments. Gold bullion cannot be used for the purpose of circulation within the country, and it is used for monetary purposes only when it is sent abroad in settlement of foreign obligations.

It is thought that even when the balance of trade is in India's favour (and consequently, the rate of exchange above 1s. 6d.) the currency may need to be contracted, and the Reserve Bank must sell gold to the public in order to reduce the volume of our token currency. This is not how our Currency Commissioners have argued. In para. 115 of the Report they state:

"And if the exchanges are stable, and keep within the upper or lower gold points set by the fixation of the price at which the Reserve Bank undertakes to buy and sell gold, it will not be called upon either to buy or sell gold."

The Reserve Bank will be called upon to sell gold only when, as the result of an adverse balance of trade, the exchanges turn against India. The contraction of the currency will take place then, and not in normal times when the balance of trade and the rate of exchange are in our favour, for as I have already shown, it will not be profitable for anyone to buy gold from the Bank at Rs. 21-3-10 per tola when the rate of exchange is at or above the upper gold point.

It should be clear that so far as the ordinary holder of rupees or notes is concerned, he would not be able to convert them into gold. When he wants gold he must buy gold in the bazar, as at present.

From the point of view of the general public, the gold backing of the token money is not tangible and visible. The right of convertibility will not be intelligible to the "uninstructed."

In the technical sense token money is said to be convertible only when it is redeemable at all times and under all circumstances, without demur or delay, in the standard legal tender

coin of the country. Token money is not convertible when it is redeemable in legal tender coins but at the option of the currency authority; and it is not convertible when the currency authority gives in exchange for it gold bullion, which is not, (and cannot be) legal tender, and in amounts not less than about Rs. 23,000. One might as well make token money redeemable in acres of land, or maunds of wheat, or tons of coal.

Our paper money is at present fully convertible into silver rupees. The meaning of this is that the Government have undertaken to give silver rupees in exchange for paper money on demand, without demur or delay, at all offices of issue. Suppose paper money was convertible into silver bars only, in amounts not less than 400 fine ounces, at Calcutta, Bombay and Madras. Then, from the point of view of the general public, paper money in that case would be inconvertible.

It will be seen that there is no fundamental difference between the gold exchange system and the gold bullion standard of the Currency Commission. The essential feature of both is that the internal currency consists of paper and token money, which are convertible into gold for the payment of international indebtedness.*

For the satisfactory working of the gold exchange system it is not essential that notes should be printed on silver. When our paper money ceases to be convertible into silver rupees, we shall have what is regarded as the "ideal" currency system, that is, a currency system in which the internal currency consists of

*"In applying Ricardo's proposals to India," wrote Mr. Lindsay, "little modification is necessary either of the proposals or of Indian currency arrangements. The only change in the proposals will be the substitution of sterling money for gold bars, and rupees for paper money." (*Ricardo's Exchange Remedy* by A. M. L. P. 8).

Dr. Edwin Cannan, in his evidence before the Currency Commission, thus commented on the difference between the gold exchange system and the gold bullion standard:

"I think when you get on to the bare bones of the gold exchange system there is very little difference between the two; some people say that this country (England) is on a gold exchange standard system now." Evidence Vol. V. P. 162, Q. 13, 210.

paper, convertible into gold for the settlement of foreign obligations. Para. 56 of the Report says:—

“It is argued by many who advocate the introduction of a gold currency that a token currency of notes inconvertible for internal purposes is the ideal end towards which India should work. The scheme outlined below carries India very far along the road towards that end...” (para. 56).

So it does—and it takes us to end of the road and almost immediately—but it is not realised that in the present stage of development, the consequences of forcing a token currency of notes inconvertible for internal purposes upon the Indian community must be disastrous—a community an overwhelming majority of whose members are illiterate, who are accustomed from time immemorial to the use of metallic coins, and who would naturally regard the new currency arrangements made by a foreign Government with mistrust.

The Currency Commission have a rise in the price of silver in view in recommending the issue of notes which will not be convertible by law into silver rupees. This question was also considered by the Currency Committee of 1920, and that Committee regarded the inconvertibility of notes so dangerous that in the event of a rise in the price of silver above the bullion par of the rupee the Committee recommended that “the situation should be met by all other available means than by impairing the convertibility of the note issue” (para. 59 of the Report of the Currency Committee of 1920). In such a case “Government would naturally endeavour to meet the demands for metallic currency by the use of gold and abstain as much as possible from purchasing silver.” The Currency Commission of 1926 advise us to start with inconvertible notes. Inconvertible notes will never be popular; they will shake the confidence of the public in the Government; they are likely to be over-issued, and they are almost certain to depreciate.

III

THE QUESTION OF A GOLD CURRENCY.

We have seen that under the gold bullion standard favoured by the Commission it is not contemplated that gold should form

part of our currency. "It (gold) *must* not circulate at first, and it *need* not circulate ever" (para. 54).

There is nothing new in the arguments by which it is sought to prove that it is not in the interests of India to have a gold currency. There are powerful interests, working behind the scenes, which have always demanded that India should continue to use silver and that she should not use gold. The gold exchange standard was recommended for India by Mr. Lindsay chiefly on the ground that under this system the demand for gold is reduced to a minimum. On page 12 of his pamphlet entitled *Ricardo's Exchange Remedy* (1892), Mr. Lindsay thus explains the advantages of the gold exchange system:

"In this way a gold standard might be established in India without risk and with considerable profit to the State and the Bank of England, and with advantage to the London money market. There would be no increase in the demand for gold, and little decrease, if any, in the demand, for silver."

The main object of the sale of Council Bills by the Secretary of State for India in excess of the Home Charges was to reduce the movement of gold from England to India**. Again

*Printed in thick type in the original.

**Mr. O. T. Barrow, who gave evidence before the Chamberlain Commission as the representative of the Government of India, frankly told the Commission that it was "desirable to check the excessive importation of gold into India." If gold was allowed to come to India, it would be used for currency or for hoarding. In either case, said Mr. Barrow, "if it went into the country and stayed there, it would mean a further drain of gold from England. It must mean a further drain, whichever it is."

Another witness, Mr. W. B. Hunter (of the Presidency Bank of Madras), who gave evidence before the same Commission, thus replied to Sir James Begbie's questions regarding the Council Bill system:—

Q.—You also favour the Council Bill system with the object of reducing the movement of gold coin from Europe to India?—This is so.

Q.—Your object is to prevent gold coin coming into India?—To prevent unnecessary gold coin being withdrawn from London at times of pressure, as I hold that a tight money market reacts on the Indian export trade.

Q.—Your object is to prevent disturbance of the London money market?—That is my chief object.

Q.—You propose to achieve that by sale of bills in London to the extent that would be sufficient for that object?—Yes.

in 1920, one of the reasons for fixing the exchange value of the rupee at 2s. (gold) was to lessen India's demand for gold.*

It is also easy to see that the Currency Commission of 1926 are opposed to the introduction of a gold currency in India in the interests of other countries. Increased demand for gold on the part of India, we are told, would make it more difficult for those countries of Europe which are "now trying to climb back gradually to the gold standard or the gold exchange standard" to carry out currency reform (para. 37). India must not do anything that might retard monetary reconstruction in Europe. The proposal is viewed with alarm in the United States of America. Again, if India adopts a gold currency, the price of silver is likely to fall. This would offend the United States, "with its great and traditional interest in silver" (para. 51), and injure China (para. 49). Injury to China, particularly, is a serious matter, for "China is the greatest, and perhaps the only great, undeveloped market left for the expansion of international trade" (para. 50).

"The extent to which India should use gold must, in our opinion," wrote the Chamberlain Commission, "be decided solely in accordance with India's own needs and wishes, and it appears to us as unjust to force gold coin into circulation in India on the ground that such action will benefit the gold-using countries of the rest of the world as it would be to attempt

Mr. Lindsay before the Fowler Committee of 1898:

Q.—3593. Do you think this (gold currency for India) would, under the circumstances, lead to an injurious appreciation of the standard of value? —I think, myself, that the two uses of gold combined, for hoarding and for internal circulation, would be so enormous that it would create a serious disturbance in the London money market.

"The fear is thought to exist that under free conditions India's absorption of gold would diminish the chances open to other countries of obtaining gold to restore the value of their insufficiently backed paper issues. The amount of gold going to India would depend on the extent to which silver purchases by the Indian Government displace private imports of gold as a means of balancing Indian trade; a higher price limit would secure a larger supply of silver, thus diminishing the gold taken by India. It follows that the fear of undue gold absorption would, *pro tanto*, met by the proposal to fix a high rate of exchange, which is recommended...below as a protection of the masses in India from the effect of high world prices arising out of the war. The volume of the currency would still be automatic, but the limits of the Government's control over the proportions of its constituent elements as between silver and gold would be extended, *pro tanto*, by fixing a higher rather than a lower limit to the Government's buying price of silver." (*Memorandum submitted to the Indian Currency Committee of 1920 by Mr. F. H. Lucas, Financial Secretary, India Office.*)

to refuse to India facilities for obtaining gold in order to prevent what adherents of the opposite school called the drain of gold to India. In any case, these arguments (which, it will be noted, are mutually destructive) are irrelevant to the inquiry which we were directed to make and to the terms of reference which confine us to a report on what is "conducive to the interests of India." (para. 67).

It is interesting to find that matters which were considered as irrelevant in 1914, when an attempt was made to show that the establishment of a gold standard with a gold currency in India would not injure other countries, and might possibly benefit them, suddenly become relevant in 1926 when it is thought that the same proposal is opposed to the interests of other countries. The position therefore is this: India cannot be allowed to use gold as currency on the ground that such action might benefit other countries; and India cannot be allowed to use gold as currency on the ground that such action might injure other countries.

IV

PLAGIARISM.

It will perhaps be said that a fall of gold prices in Europe, a fall in the price of silver and its effect on China, higher interest rates in Europe and business depression there, vitally concern us. The critic might further urge that the Currency Commissioners refer to a fall of gold prices and a curtailment of credit consequent upon increased competition for gold among the countries of the world as "In their reaction on India as one unit in the world's trade system a fall in gold prices and the curtailment of credit would on balance be unfavourable"; that they refer to the effects on China because "India, apart from her direct trade with China, which is a growing market for cotton and cotton goods, cannot escape injury from a wide-spread dislocation" of the world's trade with China; and that they do not wish to add to the world's demand for gold by recommending the gold currency standard for India as "higher interest rates, business disturbance and economic depression" in European countries, caused by India's additional demand for gold, will have "inevitable repercussions on the economic well-being and commercial prosperity of India."

The reader will be surprised to learn that the main arguments by which our currency Commissioners try to prove that

it is not in the interests of India to adopt the gold currency standard are borrowed arguments. They have adopted wholesale the views of American and certain English witnesses on this question. Not merely this. As will be seen from the extracts given below the actual words used by our Currency Commissioners in condemning the scheme for the introduction of a gold standard with a gold currency in India are the same as those employed by American and English witnesses. I give these extracts below in parallel columns as they show (1) the amount of original thinking which our Currency Commissioners did in dealing with this question, and (2) the influences which are chiefly responsible for the rejection of the gold currency standard.

UNCERTAINTY OF THE ESTIMATES OF THE AMOUNT AND TIME OF GOLD DEMAND.

Mr. Benjamin Strong.

(Governor of the Federal Reserve Bank of New York.)

The plan suggests possible loss of confidence by the Indian people in the value of silver as a store of savings, and would to that degree induce an enlarged absorption of gold for non-monetary purposes and again augment the gold requirements of the plan. . . . Evidence, Vol. V. P. 310, col. 2. (c).

Currency Report.

We anticipate that the decline in the value of silver which would result from the proposals of the scheme relating to that metal would lead to a loss of confidence by the Indian people in the value of silver as a store of savings, and would, to that degree, induce an enlarged absorption of gold for non-monetary purposes, thus augmenting the gold requirements of the scheme. P. 16. Para. 41.

EFFECT ON SILVER HOARDS.

Governor Strong.

The effort to raise the domestic price by the imposition of an import duty I personally believe would fail. . . . but assuming for the purpose of argument that it was successful in maintaining the domestic price above the foreign price, it would seem then to put the Government of India in a position of ensuring a price for silver almost for all time, because at the completion of this plan they would have sold nearly 700 million ounces of silver to the Indian people possibly at a price that was double the world price.

Evidence Vol V. P. 311 Col. 1. Q. 15,402.

Currency Report.

. . . it would put the Government of India under a moral obligation to maintain the price of silver for practically all time; for at the completion of the plan they would have sold nearly 700 million ounces of silver to the people at a price that was possibly double the world price. In our opinion, however, the effort to maintain the domestic price of silver irrespective of world price would probably fail. P. 18. Para. 48.

EFFECT ON THE SILVER MARKET, AND POSSIBILITY OF REALISING THE ASSUMED PRICE.

Statement of evidence submitted by Mr. Joseph Kitchen, Manager and Director of the Union Corporation Ltd. London.

The estimate now made indicates that to the extent of about two-thirds of the output silver is not won for its sake alone, but either as a by-product or in conjunction with gold. If a substantial fall in the price of silver were to take place, any consequent curtailment of the output would hardly affect the base metal product at all, would have more but still little influence on the production from gold ores, i.e., upon 37 per cent. of the silver production. Even here the effect would be smaller than might at first sight be expected, because, in cases where the profit is sufficiently large to leave a favourable balance at the lower price level, production would continue, and might even be stimulated in the attempt to maintain the aggregate profit, and in cases where the profit was wiped out the mines would struggle to continue their production as long as possible. Vol. III. Appendix 82, pp. 527-28.

Currency Report.

To the extent of about two-thirds of the output, silver is not won for its sake alone but either as a by-product of base metals or in connection with gold. If a substantial fall in the price of silver were to take place, any consequent curtailment of output would hardly affect the base metal product at all, would have more (but still little) influence on the production from gold ores, and would have its chief effect on silver ores only i.e., on about one-third of the silver production. Even here the effect would be slower and smaller than might at first sight be expected, because the fall in price would not affect the richer mines and the poorer mines would struggle to continue their production as long as possible. P. 17, para. 46.

EFFECTS ON CHINA.

Sir Charles Addis (Member of the Court of Bank of England).

For a long time...the Chinese have been profoundly concerned with the instability of silver as a basis of credit, and as a store of value... China is now the only silver using country left. She is surrounded by a circle of countries all of which are either on the gold standard or the gold exchange standard... They (the Chinese) would like very much, and have for a long time been anxious, to find some means of adopting gold or some form of gold exchange standard as the basis of their currency. I believe the change would have been made but for the expense. The catastrophic fall in the price of silver in terms of gold which might take place on the bare announcement that the world's production of silver for two or three years was to be for sale, would tend to stimulate the movement in favour of a change of currency in China. They

Currency Report.

For a very long time the Chinese have been profoundly concerned at the uncertainty of silver as the basis of credit and as a measure of value in China. China is now the only great silver standard country. The countries with which the bulk of her trade is carried on are all either on the gold standard or the gold exchange standard. The Chinese have for a long time been trying to find some means of substituting gold or some form of gold standard as the basis of their currency. This would probably have been done already but for the expense. The catastrophic fall in the price of silver in terms of gold, which would take place on the bare announcement that surplus silver equal to the world's production for three years was for sale, would undoubtedly tend greatly to accelerate the movement in China, and might induce her immediately to set about securing the gold needed

would do their best to devise means for securing the amount of gold sufficient to serve as a basis for instituting some form of gold exchange standard. That would in turn increase the effect already produced on silver by the Indian announcement both by a reduction in demand for China, and to some extent, by an increased supply of silver drawn from hoards. (Evidence Vol. V. P. 189, Q. 13,697).

It is true that relatively to the volume of British international trade the trade with China may seem to be relatively unimportant. But it is the greatest, perhaps the only great undeveloped country left for the expansion of *British Industry*. The immediate effect of the announcement that the Indian Government contemplated the sale of a large quantity of silver would be to throw out of gear the exchanges with China and for some time to paralyse trade with that country. All those things would react upon this country (England) very seriously (Q. 13,710).

as a basis for instituting some form of gold exchange standard. That would in turn magnify the effect which had already been produced on silver by the Indian announcement both by the reduction in demand and to some extent by the increased supply of silver that might come into the market (Para. 49).

The reactions on Chinese trade would be by no means negligible. China is the greatest, and perhaps the only great undeveloped market left for the expansion of *international trade*. The effect of the announcement that the Indian Government proposed selling a large quantity of silver would be immediately to throw out of gear the exchange with China and for a time to paralyse the growing trade of the world with that country. India, apart from her direct trade with China, which is a growing market for cotton and cotton goods, could not escape injury from a wide-spread dislocation of this kind (Para. 50).

EFFECT OF THE FALL IN GOLD PRICES ON INDIA.

Dr. Hollander of the United States.
...the drawing into India of the amount of gold proposed can only be accomplished at the cost of insecurity to those countries which have restored their monetary standards and at the risk of delay to those countries, which are now seeking, with reasonable promise, to do so, and this uncertainty and delay are likely to produce higher interest rates, business disturbance and economic depression with inevitable repercussions upon the economic well-being and commercial prosperity of India. (Evidence, Vol. V. P. 277, Q. 15,232.(vi)).

Sir Charles Addis.

A fall in gold prices would, on balance, be, I believe, *unfavourable* to India but, as indicated in my previous answer, I think the effect would be mitigated as compared with other countries by India's favourable balance of payments and the advantage she enjoys in the quasi-monopolistic nature of some of her exports. (Q. 13,676, Vol. V. P. 187).

Currency Report.

It can only be accomplished at the cost of insecurity to those countries which have restored their monetary standards and at the risk of delay to those countries which are now seeking, with reasonable promise, to do so, and this uncertainty and delay are likely to produce higher interest rates, business disturbance and economic depression, with inevitable repercussions on the economic well-being and commercial prosperity of India (Para. 53).

Currency Report.

In their reaction on India as one unit in the world's trade system a fall in gold prices and the curtailment of credit would on balance be *unfavourable* (Para. 37).

The passages quoted above show how a certain part of our epoch-making Currency Report was written. Sir Charles Addis stated that a fall in gold prices would, *on balance*, be unfavourable to India. That goes in. Did the Currency Commission strike the balance? No. Sir Charles Addis qualified his statement by saying that the reaction on India of a curtailment of the supply of credit in Europe would be relatively slight and the effect of a fall in gold prices in Europe would be mitigated in the case of India on account of the quasi-monopolistic nature of some of her exports. That is left out. Everything showing that the sale of silver by India would lower the price of that metal to 15d. or even less, goes in. But everything suggesting that a fall in price might stimulate the demand for silver for industrial purposes and the private demand of India, and that the Chinese demand is a growing one, is left out.

The most interesting reference in the Currency Report is, of course, that to China. It is shown that if the price of silver fell, the Chinese exchange would be thrown out of gear, and trade with that country would be paralysed. A whole section of the Report is devoted to "Effects on China." The whole of this section, with slight, but significant changes, is a word for word reproduction of the statement regarding China made by Sir Charles Addis before the Commission. Sir Charles said: "...it (China) is the greatest, perhaps the only great undeveloped country left for the expansion of *British industry*." The Currency Report states: "China is the greatest, perhaps the only great, undeveloped market left for the expansion of *international trade*." And at the end of the section there is a suitable reference to China being a growing market for cotton and cotton goods, in which our country is interested.

Now what Sir Charles Addis said about the effects on China, from the point of view of British industry, is perfectly intelligible. When our Currency Commissioners reproduced Sir Charles's statement in Paras. 49 and 50 of the Report, they should not have left out the reference to British industry. The reference to India in this connection is meaningless. The Chinese market is of considerable importance to Great Britain. It is comparatively of little importance to India.

The share of Great Britain in the foreign trade of China was 9.08 per cent in 1913 and 9.32 per cent in 1924; that of India, 3.6 per cent in 1923 and 2.4 per cent in 1924.* Of the total exports of raw cotton from India, China took 11 per cent in 1923 and 7.1 per cent in 1924, and Japan 45.4 per cent in 1923 and 45.6 per cent in 1924. That the dislocation of the Chinese trade might reduce China's share in our cotton exports to less than 7 per cent of the total, worries our Currency Commissioners. That the fixation of exchange at 1s. 6d. would restrict exports to Japan (about half the total exports) and other countries, does not worry them at all.

The position as regards cotton goods is more interesting still. The value of cotton piece-goods exported from India to China is so small that it is not even mentioned in the *Accounts relating to the Sea borne Trade and Navigation of British India* for the calendar year 1924. The more detailed *Accounts* for the year 1924-25 give the figures for the financial years 1923-24 and 1924-25, which are as follows:—

The quantity and value of cotton piece-goods exported from India.

Quantity.	1923-24	1924-25.
	1,000 yds.	1,000 yds.
Total exports of cotton piece-goods from India	165,329	185,511
Exports to China	55	76
Value	Rs. 1,000	Rs. 1,000
Total exports of cotton piece-goods from India	663,11	685,61
Exports to China	29	35

Converted into sterling at the rate of Rs 15 equal to £1 the value of the exports of cotton piece-goods from India to China was £1,933 in 1923-24 and £2,333 in 1924-25. As compared with this, the value of British cotton goods exported to China was £9,994,000 in 1923 and £12,621,000 in 1924.

China's share in the exports of our cotton piece-goods was .04 per cent (four-hundredths of one per cent) in 1924-25 and

*See China in the Statesman's Year Book for 1925 and 1926, Sec. Commerce.

.03 per cent (three hundredths of one per cent) in 1923-24. The value of the exports of British cotton goods to China is *five thousand times* greater than that of Indian exports of cotton goods to China.

I owe the reader an apology for devoting so much space to China, but I have done so with the object of bringing home to our Currency Commissioners the disadvantages of plagiarising. Sir Charles Addis, as I have already said, looked at the question from the point of view of British industry. Our Currency Commissioners clumsily adapted his statement for Indian readers without examining the figures of India's trade in cotton and cotton goods with China. It is pretended that if the price of silver fell, trade with China would be paralysed, and this would be the beginning of India's ruin. Therefore, in the interests of India, we must not do anything that may paralyse trade with China.

V

PROBABLE EFFECT OF THE ATTEMPT TO CHANGE TO GOLD IN INDIA ON THE UNITED STATES AND EUROPE.

Sir Basil Blackett stated before the Currency Commission :—

"If the effect of a decision to attempt the change to gold is going to be to upset the gold standard in the United States or in Europe, India has clearly nothing to gain by the attempt."

And the Currency commission add :

"In our opinion the attempt would be very likely to have the consequences to which he refers." (para. 53).

Unfortunately, our Currency Commissioners do not tell us how they have arrived at the remarkable conclusion that the demand on the part of India for £103,000,000 is likely to upset the gold standard in the United States and in Europe.

Let us first consider the position in regard to the United States.

The United States is to-day the richest country in the world, with the largest stocks of gold. She has been able to amass enormous amounts of gold on account of her creditor position. The gold reserves of the note-issuing banks of the world at the end of 1913 and 1923 are shown by the following table :—

*Gold Reserves of the note-issuing banks of the world at the end of 1913 and 1923**

	Million 1913.	Dollars 1923.
1. The United States of America	1290.0	3832.0
2. Europe:		
France	678.7	1069.0
England.....	170.2	754.4
Spain	92.6	487.7
Italy	288.0	329.6
Holland	64.4	228.8
Germany	296.3	124.5
Roumania	29.2	107.2
Switzerland	32.8	103.7
Sweden	27.4	72.8
Denmark	21.0	56.2
Belgium.....	48.0	52.2
Russia	872.3	45.2
Norway.....	11.9	39.5
Czecho-Slovakia	—	26.9
Yugoslavia	(13.5)	13.3
Poland	—	13.1
Greece	4.8	12.0
Portugal	8.1	10.5
Austria-Hungary (Bank)	251.5	(8.4)
Finland.....	7.0	8.2
Bulgaria.....	10.7	7.6
Estonia.....	—	7.5
Lithuania.....	—	3.2
Lithuania.....	—	1.6
Austria	—	1.3
Hungary	—	4.6
3. Non-European States:		
Japan.....	112.2	561.1
Australia	185.9	228.6
Canada.....	161.6	184.2
British India.....	185.9	108.5
Dutch East Indies	10.0	63.7
Union of South Africa	39.9	60.8
Uruguay	10.9	57.9
Brazil	89.6	48.7
Peru	(2.4)	21.6
Egypt	10.5	10.6

At the end of the year 1923 the gold reserves of the United States amounted to 3,832,000,000 dollars, while the gold reserves of all European note-issuing banks taken together amounted to

**Das Geldproblem in Mitteleuropa*, by Dr. E. Hantos, Gustav Fischer Jena, 1925, p. 158.

only 2,820,000,000 dollars, and of the remaining non-European States 1,332,000,000 dollars. Of the total gold reserves of the world the share of the United States was more than half.

The gold reserves of the United States in May 1926 amounted to 18,865 million marks (about £9,433,000,000) and of all Europe to 13,503 million marks (about £6,752,000,000).* There is more gold in the Federal Reserve Banks than in the combined reserves of the Central Banks of the whole of Europe (including the United Kingdom).

The economic position of the United States is exceptionally strong. She holds Europe in fee. The total sum lent by the United States during the war to twenty different countries amounts to no less than 10,340,000,000 dollars.** The debtor

**Wirtschaft und Statistik*, No. 14, July 1926.

***War Debts owing to the United States.*

A. Funded.	In 1,000 dollars
1. England	.. 4,277,000
2. France	.. 3,404,819
3. Italy	.. 1,648,034
4. Belgium	.. 379,087
5. Poland	.. 159,667
6. Czecho-Slovakia	.. 91,880
7. Roumania	.. 37,923
8. Estland	.. 3,099
9. Finland	.. 8,282
10. Litau	.. 4,982
11. Hungary	.. 1,686
12. Lettland	.. 5,132
13. South Slavia	.. 51,038
Total A	.. 10,083,529
B. Unfunded.	
14. Russia	.. 192,601
15. Austria	.. 24,054
16. Greece	.. 15,000
17. Armenia	.. 11,960
18. Cuba (paid back)	.. 10,000
19. Nikaragua	.. 140
20. Liberia	.. 32
Total B	.. 253,787
Grand Total	.. 10,337,316

Article in the *Wirtschaftsdienst*, Hamburg, (11th June, 1926) by Dr. Karl Kraemer on *Stand der Kriegsschuldenregelung mit der Vereinigten Staaten.*

countries will be repaying their debts, together with interest, in gold, to the United States, during a period of 62 years. A great part of the reparation payments made by impoverished Europe, directly or indirectly, finds its way to the United States (*Speech of the British Chancellor of the Exchequer in Parliament, 24th March 1926*).

To say that this country, with its immense hoards of gold and unlimited resources, with all its heavy claims on Europe and its creditor position which is assured for the next half-a-century, is likely to have its gold standard upset on account of India's additional demand for gold, is *absolute nonsense*.

According to Dr. Sprague's statement (Q. 15,293) the United States has something between 1200 million and 1500 million dollars of gold which might be withdrawn from that country without necessitating credit contraction and lower prices. Our plan requires about 500 million dollars in all (a little over £100,000,000, spread over 10 years). If the Federal Reserve Banks lent us the entire sum of 500 million dollars, then all that would happen to the United States would be that the reserve ratio of the Federal Reserve Banks would be reduced from 70 per cent. to about 60 per cent. "They would," said Dr. Sprague, "still be in a very comfortable position. Thus you can see that it is entirely possible to finance this plan in the United States without any difficulty whatever if the plan itself appears to be desirable for all parties concerned" (*Minutes of Evidence Vol. I. P. 295, col. 2*).

There is not a word of suggestion here that the change to gold in India is likely to upset the gold standard of the United States. As a matter of fact, the United States could easily spare for us, apart from other considerations, double the total amount of gold that we want, without having her gold standard upset thereby.

The economic situation in Europe to-day is dominated by the debt payments to the United States. The United States, and not India, is retarding monetary reconstruction in Europe. If the United States is so anxious to assist the economic revival of Europe, let her cancel the debts that Europe owes her. Appeals are made to the United States almost every week in European

papers begging her, in piteous terms, for mercy, appeals to which she has hitherto turned a deaf ear. The United States will be ready to accuse India of retarding monetary reconstruction in Europe if she takes a beggarly £103,000,000 from the world's gold reserves. What about her own claims on Europe amounting to over £2,000,000,000 (10,337,316,000 dollars)? What about her own gold reserves which exceed the combined gold reserves of the whole of Europe, and which have been built up at the expense of devastated Europe? It is remarkable that American witnesses should ask India not to do anything that may retard monetary reconstruction in Europe, and it is more remarkable still that the statement of the American witnesses should be reproduced word for word in the Report of the Currency Commission, without a warning to the reader that the opinion expressed as to the probable effect of India's demand for gold on Europe is the opinion of American witnesses which the Currency Commissioners have, without acknowledgment, or any examination or analysis, adopted as their own.

Mr. Denning's scheme for the introduction of a gold standard in India by stages requires £15,000,000 at the time of the initiation of stage I, a further £35,000,000 within a year, and £53,000,000 over a period of ten years. Stage I could be easily introduced if we were allowed to convert our 80 million crores of sterling securities into gold (we have in all 109 crores of gold and gold securities). We have certainly the right to do so, but it is thought that this conversion would seriously disturb the London money market, and it is for this reason that Sir Basil Blackett sought the co-operation of the authorities in London and New York for giving us the gold we want.

The position is that the United States has the gold but, for reasons which we shall examine presently, will not give it. So far as London is concerned, we have the opinion of Sir Basil Blackett that "if popular opinion were more educated, a reserve of £150 millions to £160 millions is unnecessarily large" (*Evidence Vol. IV. Q. 530*). The gold reserves of England, therefore, could spare something for us, but no help is to be expected from this quarter either. Why? There is the old bogey of drain of

gold to India and a fall of gold prices. The effect of the change to gold in India would be first felt in London. The proposed amalgamation of the notes of the Bank of England and of the Treasury might have to be indefinitely postponed. There would be a diminution in the supply of credit, and the rate of interest would rise. A general fall of gold prices would tend to lower the cost of living and the money wages of European countries in relation to those in America. (*Evidence of Rt. Hon'ble Montagu Norman, Governor of the Bank of England, Vol. I. Q. 13,664, 13,666 and 13,673*).

That is how India's additional demand for gold does not suit Europe. European countries must either contract their credit circulation and let gold prices fall, or resort to temporary inflation. This assumes that it is impossible for India to obtain the necessary gold by mutual agreement between the authorities in London and New York. If this were possible, gold prices need not fall, or inflation need not occur anywhere. We must not forget this. And the evidence of Sir Basil Blackett before the Currency Commission shows that he is not convinced that it is impossible for us to secure the necessary supplies of gold without retarding monetary reconstruction in Europe, assuming that London and New York help us (*see Q. 530-538, Evidence Vol. II*).

A further question may be asked: Supposing the establishment of a gold standard with a gold currency in India leads to a contraction of credit in Europe and a fall of gold prices, what is likely to be the effect of this upon India? After all, we are primarily concerned with India, not Europe. The answer is that India's economic position is one of considerable strength, and that she is not likely to suffer much, if at all, on account of the fall in gold prices. She has nothing to fear so long as the foreign demand for her exports remains strong, and the balance of trade remains in her favour. And there is no danger of the balance of trade turning against her if gold prices fall. Our Currency Commissioners have much exaggerated the effect of the reaction on India of a fall in gold prices.

THE PROBABLE FALL IN THE PRICE OF SILVER.

It is almost certain that India will not be allowed to adopt the genuine gold standard with a gold currency. This is mainly because the co-operation of the United States and England, on which we depended for getting the necessary gold, without disturbing the world's money markets, is not forthcoming.

The position of the United States in this whole controversy is perfectly clear. She has important silver interests, and she does not want to see her silver mining industry injured by a fall in the price of silver. The question for her is not merely economic; it is partly political.*

In the scheme for a gold standard prepared by the Officials of the Finance Department a fall in the price of silver, as the result of the sale of silver by India, to 24d. is assumed. The American witnesses, taking an alarmist view of our proposals, (as they naturally would, considering their "great and traditional interest in silver") tried to show that the price of silver was likely to fall much below 24d. (15d. or even less). Our Currency Commissioners have taken the same view, I think, on insufficient grounds.

Mr. Denning's assumption that the price of silver was not likely to fall below 24d. was based on the following general considerations: (1) a heavy fall in the price of silver would stimulate the use of silver for industrial purposes and for subsidiary coinage; (2) between 1922 and 1923 the world production of silver increased by 32 million ounces, but this very considerable increase in production did not appreciably affect the price, which tended to rise rather than to fall. Mr. Denning also referred to the sale of silver by Germany when she adopted the gold standard after the Franco-German war. Germany sold one-and-a-half year's world production of silver and the price fell by 9d.

*"No administration, I believe, could resist public outcry against an Indian credit which, in the first place, would seem not to fit into the programme of productive use of American capital, and which would be interpreted as hostile, perhaps fatal to a great American industry affecting a wide area" (*Dr. Hollander's statement before the Currency Commission, Evidence Vol. V. P. 279*).

From Mr. Denning's evidence it appears that he did not know all the facts about the sale of silver by Germany, or he would have made out a much better case than he did for assuming that the price of silver was not likely to fall below 24d.*

When Germany attempted the change to gold she had 1530 million marks in circulation. Of this 450 million marks were required for use as subsidiary coins; the remaining 1080 million marks had thus to be converted into gold. This represented 6 million kilograms of silver; the yearly production of silver at that time was about 2 million kilograms.

From 1871 to 1879 the German Government sold about 3 1/4 million kilograms of silver. The sale had to be stopped in that year on account of the outcry against the fall in the price of silver, which was wholly attributed to the action of the German Government. In 1885 and 1886 the German Government was able to get rid of more silver by minting silver coins wanted by Egypt.

The average price of silver in 1871 per standard ounce in London was 60 1/2d. and in 1879, 51 1/4d. The fall in price was thus 15.3 per cent; Mr. Denning assumed a fall in price from 33d. to 24d., or a fall of 27.3 per cent.

The fall of 15 per cent which occurred in 1879 cannot be attributed solely to the sale of silver by Germany:

(1) Between 1871 and 1879 silver production increased considerably. The annual average production from 1871 to 1875 amounted to about 2 million kilograms, and from 1876 to 1880, to 2.5 million kilograms, an average annual increase of 25 per cent.

(2) India's demand for silver decreased considerably in this period. It fell from an average of 71 million rupees annually from 1866 to 1869, to 35 million rupees annually from 1870 to 1876. The excess of silver production over net imports of silver into India is estimated as follows:

*For full information about the German monetary reform of 1873 the reader should turn to German authors. The facts given here have been taken from Helfferich's authoritative work *Das Geld*, 5th Ed., Leipzig, 1921, and Conrad's *Grundriss der politischen Oekonomie* 1st Part, 10th Ed., Jena, 1921.

	Kilograms.
1866-70	330,635
1871-75	1,641,825
1876-80	1,695,812

(3) The countries of the Latin Monetary Union (France, Italy, Switzerland and Belgium) limited the free coinage of silver in 1873 and finally stopped it in 1878. Sweden, Norway and Denmark adopted a uniform system of gold coinage in 1872. The Netherlands began to coin gold in 1875 and stopped the coinage of silver in 1877.

(4) The use of gold for industrial purposes increased more rapidly in this period than that of silver.

It should be clear that the fall in the price of silver which occurred between 1871 and 1879 was only partly due to the sale of silver by Germany. It should also be noted that the heavy decrease in the demand for silver which was caused by the reduction in the Indian demand, the stoppage of the coinage of silver in more than half-a-dozen countries, and the sale of silver by Germany, all combined did not lower the price of silver by more than 9 1/4d., or 15.3 per cent. The German analogy, therefore, shows that if India sold her silver gradually, over a period of years (10 or even more, if necessary) the price of silver need not fall by more than 9d.

It is argued that the methods of silver production have changed, and that two-thirds of the total silver produced is now won in connection with the mining of the baser metals. This is intended to show that the fall in the price of silver would not reduce silver production at the present time. But we have to remember that between 1871 and 1879, *in spite of the increase in production* and a very great reduction in the demand, the price did not fall more than 9 1/4d. It may be expected that a fall in the price of silver would discourage silver mining to some extent, and it is reasonable to hope that the demand for silver for industrial purposes in Europe and India would increase. This possibility is recognised even by American witnesses (*Evidence,*

Vol V. Q. 15,224, and Appendix 82 Vol. III, p. 531), but our Currency Commissioners do not refer to it. Nor do they refer to the development in the demand for silver in China (which is also admitted by American witnesses). On the other hand, our Currency Commissioners argue that when the price of silver falls, China might think of adopting a gold standard, which, I suppose, would be a calamity for the world in general. We are not concerned with what China might or might not do; we have only to examine, in the light of given conditions, the probable effect on the silver market of the change to gold in India.

VII

THE "MOST SOLID ARGUMENT" IN FAVOUR OF A GOLD CURRENCY.

The Indian demand for a gold currency is not a new demand. It has a long history, which may be briefly summarised here as it has some bearing on the present controversy. It is thought that India does not desire a gold currency; the fact is that *for about a hundred years Ind'ia has been wanting nothing else.*

Before 1835 a great variety of gold and silver coins circulated in different parts of the country. The Act No. XVII of 1835 made the silver rupee the standard coin throughout British India.

By Section 9 of the Act of 1835 it was enacted that "no gold coin shall henceforward be a legal tender for payment in any of the territories of the East India Company." The Court of Directors, however, in their Despatch of 1806 had stated that "it is not by any means our wish to introduce a silver currency to the exclusion of the gold, where the latter is the general measure of value, any more than to force a gold coin where silver is the general measure of value."* In para. 16 of the Despatch they clearly defined their attitude towards the use of gold as currency:—

"Although we are fully satisfied of the propriety of the silver rupee being the principal measure of value and the money of account, yet we are

*Copy of the Despatch addressed by the Court of Directors to the Governments of Bengal and Madras on the 25th day of April 1806 dealing with the Coinage of India. Ordered by the House of Commons to be printed, 23 March 1898. No. 127. Para. 22.

by no means desirous of checking the circulation of gold but of establishing a gold coin on a principle fitted for general use. This coin, in our opinion, should be called a gold rupee and be made of the same standard as the silver rupee, viz. 180 troy grains fine gold, also divided into halves and quarters, so that the coins of both gold and silver should be of the same denomination, weight and fineness."

The gold pieces of 5, 10, 15, and 30 rupees coined under the Act of 1835 were not legal tender, but by a proclamation issued in 1841 officers in charge of public treasuries were authorised to receive the gold coins struck under the provisions of the Act of 1835 at their denominated value, until they should have passed a certain limit of lightness, when they were to be taken as bullion only, by weight. It could have been foreseen that gold would be brought to the Government only when the market price of gold fell below the silver denomination of the gold coin, and that Government could not use this gold in making payments to the public as it was not legal tender. Gold began to accumulate in Government treasuries. By a Notification issued in December 1852 it was declared that beginning with January 1853, "no gold coin will be received on account of payments due, or in any way to be made, to the Government in any public treasury within the territories of the East India Company."* Gold, however, continued to be received into the mints for coinage under the Act of 1835.

While the action taken by the Government tended to discourage the use of gold as currency, the fall in its price, consequent upon the discoveries of gold in Australia and California, considerably increased the demand for gold. Memorials were submitted to Government by various Chambers of Commerce praying for the introduction of a gold currency.**

The case for the introduction of gold into circulation in India was ably argued by Sir Charles Trevelyan (Finance Member, Government of India) in a minute dated the 20th June, 1864*** Information collected by Sir Charles Trevelyan from all parts of India showed that there was a general desire for the

*East India Coinage. Return to an Address of the Hon. the House of Commons dated 24 February 1860. Ordered by the House of Commons to be printed, 27 April 1860. No. 254, p. 5.

See Appendix A. *See Appendix B.

introduction of gold coins in India, that the people of India were well acquainted with the sovereign, and there was every reason to think that the introduction of the sovereign would be well received, and that it would circulate freely at 10 rupees. The Secretary of State, however, did not think it advisable to make the sovereign legal tender, but as an experimental measure he suggested that the sovereign and the half sovereign should be received into and paid out of the public treasuries in India for ten and five rupees respectively, and effect was given to this proposal by a Government Notification in November 1864. The rate was raised to Rs. 10-4 for the sovereign and Rs. 5-2 for the half sovereign in October 1868. Shortly afterwards the gold price of silver began to fall, which entirely changed the Indian currency situation, and the Government of India adopted the following Resolution on the subject of a gold currency on 7th May 1874:—

“The expediency of introducing a gold currency having been considered, the Governor-General in Council is not at present prepared to take any step for the recognition of gold as a legal standard of value in India.”

The fall in the rate of exchange after 1873 led the Calcutta Trades Association and the Bengal Chamber of Commerce in 1876 to ask the Government to suspend the coinage of silver by the Indian mints. The Government declined to interfere with the standard of value. Two years later, however, the Government changed their opinion and expressed their willingness to give “a certain limited scope” to the introduction and use of gold coins in India, “so far as it was found convenient or profitable.” Their proposals were referred to a departmental Committee in England which made short work of them. The Committee briefly reported that they were “unanimously of opinion that they cannot recommend them for the sanction of Her Majesty’s Government.”

In 1892 we find the Government of India again advocating a gold standard for India. The Herschell Committee, while not advising the Secretary of State to over-rule the proposals of the Government of India for the closing of the mints and the adoption of a gold standard, suggested certain modifications of these proposals which were adopted by the Government. The question of a gold standard was favourably considered by the Fowler Com-

mittee, but no sooner had their report been published than the British Treasury began to oppose their scheme tooth and nail. For two years, from 1899 to 1901, says Mr. Keynes, "they made a succession of technical difficulties in a spirit of scarcely veiled hostility to the whole proposal." In May 1901, however, some agreement was arrived at between the authorities in England and in India as regards the establishment of a gold mint at Bombay. "At this point in the negotiations," says Mr. Keynes, "the natural instincts of the Treasury Officials became uncontrollable and respect for independence of the India Office had to be abandoned. Their first line of defence in the form of technical difficulties having been overcome, they fell back upon open argument as to the wisdom from the Indian point of view of the whole project."*

They urged that the gold standard had been firmly established in India, that sovereigns were readily attracted to India when required, that the estimates of the Government of India of gold available for coinage were less than was anticipated, and that the staff of the proposed Indian mint would have to be maintained in idleness for a large part of the year at considerable cost to the Indian exchequer. "It is, of course, for Lord George Hamilton (the Secretary of State) to decide," said the Lords of the Treasury in conclusion, "whether in spite of these objections the scheme is to be proceeded with." The India Office informed the Treasury that His Lordship was not inclined to abandon the scheme. The Treasury's reply was: "My Lords cannot believe that the position of the gold standard in India will be strengthened, or public confidence in the intentions of the Government confirmed, by providing machinery for gold coins *which is neither demanded nor required by the mercantile community*, while on the other hand, the failure or only partial success of a gold mint would, undoubtedly, be pointed to by the opponents of the gold standard policy (although without justification) as evidence of the break-down of that policy" (*italics mine*).

Thanks to the opposition of the British Treasury, no gold mint was established in India. But in accordance with the recommendations of the Fowler Committee the sovereign was de-

*Indian Currency and Finance 1924, pp., 64-66.

clared legal tender in 1899. We shall now consider, briefly, how far this measure encouraged the use of gold as currency.

An attempt was made by Government in 1900 to introduce gold into circulation. Payments of gold from the Currency Reserve commenced on 12th January, 1900, at the currency offices in Calcutta, Madras and Bombay, and towards the end of that month at the remaining currency offices. "The instructions issued were to tender gold to all presenters of notes, but to give rupees if they were preferred." Later on sovereigns were sent to the larger District Treasuries with instructions that they should pay sovereigns to any one who might desire to receive them in exchange for rupees, or in payments due by the Government. In March, 1900, the Post Offices in the Presidency towns and Rangoon were instructed to give gold in payment of Money Orders, and the three Presidency Banks were directed to issue sovereigns in making payments on Government account. These arrangements continued in force throughout 1900-01, and it was estimated that about £6,750,000 was put into the hands of the people. Of this amount part was exported, and more than half returned to Government, so that not more than £3,000,000 remained in the possession of the public. Because a considerable amount of gold had returned to Government it was thought that the people did not want gold as currency and preferred rupees. The Comptroller of Currency in his *Report on the Operations of the Currency Department for 1899-1900*,* said: "The issues of sovereigns from currency offices under these orders were not inconsiderable, but the receipts continued large and considerably in excess of the issue. Gold has apparently not yet begun to circulate in the country as money." But, probably, gold had begun to circulate as money. In the case of an agricultural community payment of Government dues is the chief item of expenditure. The return of gold to Government was not an indication of the desire of the agriculturists to get rid of the gold as fast as possible; it rather showed that the people were using gold as money should be, and is meant to be, used. If the gold had remained in the possession of the people it would have been said that it had been hoarded.

*Annual Report (Superintendent Government Printing, Calcutta). See in each case Section dealing with gold circulation.

The net absorption of sovereigns in 1901-02 amounted to £.9 million. The increase in the popularity of the sovereign is shown by the increase in the amount of the absorption every year. The amount absorbed was £1 million in 1901-02, £2 millions in 1903-04, £2.2 millions in 1904-05, £2.7 millions in 1905-06 and £3.9 millions in 1906-07. "The absorption in the year under report," said the Comptroller of Currency in his report for 1906-07, "has so far been the highest on record, the United Provinces and the Punjab showing the largest demand." But the absorption in 1907-08 (£6.2 millions) was 59 per cent greater than that in the preceding year. "The absorption in the year under report," said the Comptroller of Currency in his report for 1907-08, "has been the highest on record, the most notable increases having occurred in the United Provinces, the Punjab, Burma, Madras and Calcutta." The absorption in the year 1908-09 was only £2.4 millions, but "It would have been higher than ever had gold been available throughout the year." The receipts at the currency offices from imports during the year amounted to £7,139,000 but the gold was received only in the closing months of the year. There were no receipts from April to October 1909 (both inclusive). In 1910-11 the total absorption amounted to £7,187,000 as compared with £6,220,000 in 1907-08. As regards the popularity of the sovereign, the Comptroller of Currency in his report for 1910-11 acknowledged that "the apprehension that the sovereign would not be popular was not well-founded. . . ." But he pointed out that "the acceptance of the sovereign is not yet general," possibly due to the fact that they were not everywhere offered. The Comptroller also doubted whether the sovereign had established itself as currency, though he recognised that "so far as it pays for produce and so far, again, as it comes back in payment of revenue, it acts as currency." His theory was that the acceptance by the cultivator of gold in payment of his crops was, probably, in the nature of barter. In 1911-12, however, the absorption of gold in Northern India and Bombay necessitated special enquiries as to the exact use made of the gold. The result of the enquiries was published in the Currency Report for 1911-12.

The enquiries showed that a very considerable proportion of the gold absorbed in the Punjab was actually in circulation as currency; that, in some cases, better rates and terms could be obtained when gold was tendered in payment of produce than when silver was offered, gold thus being practically at a premium. "The people preferred gold because it was less troublesome than silver money." The enquiries made in the Gujranwala District showed that all the grain agents paid the Zamindars chiefly in gold and that the Zamindars paid their revenue in gold. "The Zamindar prefers to have his price for the grain in gold as he can easily carry it and easily exchange it, and if necessary, put it away. He shies at currency notes of any value as they cannot be easily exchanged, and to receive payment in silver means cost of carriage and a greater risk of being robbed." Gold was, in short, preferred because it is money of higher monetary utility than silver. The enquiries made in Bombay showed that gold was not being hoarded or melted to the same extent as before, and that gold circulation was steadily increasing. The enquiries made in the United Provinces, Madras and Burma showed similar results.

The total absorption of sovereigns in 1912-13 (£10,245,000) was more than a third in excess of that in 1911-12 (£7,600,000) Special enquiries were again made as to be exact use to which the sovereigns were put, which confirmed the result of the enquiries made in the preceding year.*

In 1913-14 the absorption of sovereigns amounted to £12,074,000. Special enquiries made in this year showed that in "certain parts of India, at any rate, sovereigns are used to an increasing extent in real currency transactions." The sovereign had "certainly displaced silver to some extent in Bombay and the United Provinces, and probably in a lesser degree in Madras and Burma also."** The general conclusion of the Comptroller of Currency was that "in large portions of India the sovereign is now entering largely into ordinary transactions in cases in which

*Page 24 of the Report on the Operations of the Currency Department for 1912-13.

**Page 28 of the Report on the Operations of the Currency Department for 1913-14.

they are of sufficient size to make its use possible."

From the evidence quoted above it would appear that before the war there was a genuine demand for gold for currency purposes in India.

Gold went out of circulation soon after the outbreak of the Great War, and there is no gold in circulation at the present time, but no one can deny that Indian public opinion is overwhelmingly in favour of a gold currency. If that is so (and it is so), this, in the words of J. M. Keynes, is "the most solid argument"* in favour of a gold currency.

It is curious that a foreign witness** should have had to plead before an Indian Currency Commission that some regard ought to be paid to Indian academic and commercial opinion on this question. Sir Alexander Murray (Currency Commissioner) asked Keynes: "You think that the academic opinion in India, although of very small volume, is of such value that it ought to be carefully weighed as against the unexpressed opinions of 80 or 90 per cent of the population?" It is suggested that the academic opinion in India does not represent the opinion of the inarticulate population. The steady increase in the absorption of sovereigns into circulation from 1900 to 1914 is an incontestable proof of the fact that the masses of India want gold in

*Evidence Vol. V. P. 160, Q. 13,171.

**Keynes's evidence before the Currency Commission:—

Q.—13,172...Frankly my opinion is that Indian opinion is in favour of it (gold currency), in the same sense in which British opinion was in favour of the gold standard a year ago. In this matter there is always only a small minority of the public who take any intelligent interest in it. If you take good class academic opinion in India, which I think ought to have some deference paid to it in a matter of this sort as representing true Indian opinion, I should have said that the weight of good academic opinion in India was in favour of a gold currency. Many professors whom I consider deserve respect in other matters have expressed that view, and although I disagree with them on that I do not think their opinion ought to be swept on one side.

Q.—13,173. (Sir Alexander Murray) I appreciate that. You think that the academic opinion in India, although of very small volume, is of such value that it ought to be carefully weighed as against the unexpressed opinions of 80 or 90 per cent of the population?—Yes, I think it ought, because it is not only Indian academic opinion but there is also a considerable volume of Indian business opinion to the same effect. I think all the methods one has of gauging Indian opinion would lead to the conclusion that Indian opinion, so far as it is intelligent and articulate, supports this. (Evidence Vol. V. P. 160).

circulation. One may go further and say that if the question were referred for decision to the people of India, not one per cent of the total population would vote against a gold currency. Would Sir Alexander Murray seriously maintain that the "unexpressed opinions of 80 or 90 per cent of the population" are in favour of the gold bullion standard of the Currency Commission? It is self-deception to think that the masses of India would love the rupee note when it ceases to be convertible by law into silver rupees, and that they would be over-joyed when they learn that rupees and notes would be convertible into gold bars at Bombay, Calcutta and Madras in amounts not less than 400 fine ounces, the obligation of the Reserve Bank to sell gold being so framed "as to make it unprofitable for gold to be bought from it except in circumstances in which it would be profitable to do so for purely monetary purposes" (*i.e.*, for export).

So much has been said, for the benefit of the people of India, about a gold currency being a sign of backward civilisation, that I may draw attention here to the views of the Rt. Hon.ble Montagu Norman, Governor of the Bank of England, on the subject.* At the present time, notes are fully convertible into gold for internal purposes only in the United States. But European countries, which are gradually climbing back to the gold standard, are endeavouring to increase their gold reserves,

*The evidence of the Rt. Hon. Montagu Norman before the Currency Commission:—

Q.—13,689. Will you be able to express an opinion as to whether the idea of reverting to gold currency in the matter of convertibility of the note may be said to have been practically abandoned? (Mr. Montagu Norman. That is circulation of coin?)

Q.—13,690. Convertibility of note into gold coin circulation?—Well, speaking for myself, I hope that the time may arrive both in this country and in India, when circulation of gold coin may again be resumed. So far as this country is concerned, I think it is very remote. I rather suspect that so far as India is concerned, it is equally remote. I do not expect to see it in this country myself.

Q.—13,691. You mean in your lifetime?—I mean in my lifetime; but *I like to cherish the hope that it will come back again, and will be a sign of that prosperity (backward civilisation?) which I trust we may reach again.*

Q.—13,692. As regards British policy, you faintly trust to the latter hope?—*I intend to work for that end, but I do not expect to see it in my lifetime.*

so that an increasingly larger proportion of their note circulation might be covered by gold. It is not at all unlikely that the leading countries of Europe, when they find that they have secured a sufficient amount of gold, would, the United Kingdom leading, eventually (it may not be for several years) make their notes convertible into gold coin.

Ludwig Mises, one of the leading German writers on money, in his book *Theorie des Geldes und der Umlaufsmittel** says:

"European thought to-day, in regard to the question of currency, does not extend beyond the wish: 'Return to gold currency' (*Rueckkehr zur Goldwahrung*). This is thoroughly understandable, as a gold currency has hitherto, on the whole, worked satisfactorily; it is true that it has not enabled us to attain the unattainable ideal of an unvarying internal, objective purchasing power of money, but it has kept the monetary system free from the influence of the Government and changing political aims." (p. 401).

And again—

"When the population becomes accustomed to the effective use of gold in daily intercourse, it will more strenuously oppose a policy of inflation than did the peoples of Europe in 1914. It will not be so easy, then, for the government to deny the reactions of waging war on the currency system; the government will be forced to justify its war policy. The maintenance of an effective gold circulation will prove costly in the case of particular peoples, and it will at first lead to a general fall of prices; there is no doubt about that. Still we must put up with these disadvantages if we wish the currency system to serve other ends than those of preparing for war, revolution and disruption." (p. 405).

The witness, of course, admitted (and who would not?) that a gold currency is uneconomical, that gold in reserves is far more useful than gold in circulation for the maintenance of exchange and that a note is more convenient than gold coin for carrying in one's pocket (Q. 14,451-54). But in answer to the question 14,453 "Then your dream will never be fulfilled?" the witness replied, "*I cannot say. I do not attempt to prophesy what will happen after our lifetime.*"

As regards the circulation of gold coins in the United States the same witness stated:—

Q.—14,492. You referred to the United States as the only country which has a gold circulation? Now.

Q.—14,493. Now. Did you refer to the circulation of gold coin or had you in mind the circulation of what are called gold certificates?—I was thinking of both. I believe there is a considerable amount of gold coin in circulation as a matter of fact. I was rather surprised to see it when I was there last. I was thinking of the two together; I do not differentiate all

between them.
 clusion *Duncker and Humblot, Leipzig 1924.
 this. (

We in India are also thoroughly tired of currency systems which can be manipulated by the Government for its own ends. The chief merit of the genuine gold standard is that it works automatically, and with the minimum of governmental interference. It is a very sound principle which says that in currency matters a government should do as little as possible (evidence of Dr. Marshall before the Fowler Committee), and judged from this point of view there is nothing to beat a gold standard with a gold circulation. It will be seen that it is not the advocates of a gold currency who mislead the public, but those who try to persuade the public to believe that if India has gold in circulation, she will be branded for ever among the nations of the world as a country backward in civilisation.

Appendix A.

The respectful Memorial of the Bombay Association, to the Right Honourable Sir John Lawrence, Bart. G. C. B., K.S.I., etc., etc., etc., Viceroy and Governor General of India in Council, dated 18th February 1864. Sheweth,

* * *

3. That from time immemorial until some years ago India possessed an extensive gold currency.

4. That the superior convenience of this circulating medium was well understood by the natives of this country.

5. That the measures adopted by the British Government for the regulation of the money of India had the effect of gradually suppressing a gold and extending a silver currency, and that finally in 1835 an Act was passed declaring gold no longer a legal tender.

6. That these stringent regulations have virtually extinguished a gold currency in India, but have by no means extinguished its popularity.

7. That the few gold coins remaining in circulation are greatly prized and command a considerable premium in the market.

8. That rude attempts are made by some of the natives of India to remedy the defects of the present inconvenient silver currency by circulating gold bars authenticated by the stamp of Bombay banks.

Appendix B.

Extract from a Minute on a Gold Currency for India by Sir C. E. Trevelyan, dated June 28, 1864.

... Without going back to the history of former times, gold pagodas and fanams formed the bulk of the circulation of the South of India within the memory of persons still living; and, in the North of India, although the gold mohur was overvalued with reference to silver, its superior convenience obtained for it a considerable circulation. The trade of India with the countries beyond its north-western frontier has always been carried on by means of gold coins of various kinds.

The action of the Government upon this state of things was first to exclude gold from the circulation and then to introduce a paper currency based upon silver. The result is that India attained the last step *per saltum*, with the omission of the one which ought to have preceded it. Retrogression has been followed by irregular advance.

Although gold is not available as a legal tender in payment of debts and taxes in British dominions in India, the people in some parts of India have endeavoured to remedy the defects of the present inconvenient silver currency by circulating gold bars authenticated by the stamp of Bombay banks. This rude attempt to organise an ingot currency in the face of every discouragement, proves the determination of the people to have gold, and shows that the Government would be cordially seconded by them in any attempt to introduce a gold currency on a sound footing.

A still more striking instance is that gold coin is in such request, that real gold mohurs, nearly of standard value, are habitually made by forgers, chiefly to secure the premium on which they sell.

Many other proofs might be adduced of the popularity of gold coinage in India. The Native State of Jeypore has long enjoyed a reputation for the purity of its coins; and Jeypore gold mohurs, which were formerly seldom seen, have of late years obtained an extensive circulation. In the Punjab, the use of gold,

as a medium of exchange, has greatly increased of late years. In the Seikh time it was chiefly procured from Russia through Kabul; but, to use Mr. Melvill's words, "the facilities for communication with Calcutta and Bombay, which are freely supplied from Europe and Australia, have given the precedence to those markets in the supply of gold." Mr. McLeod reports that the sovereign is now the gold coin most familiar to the people of the Punjab, "being by far the most abundant and almost the only one now employed systematically for equalising the exchange."

But the most decisive example of all will be found in the Madras correspondence in the Appendix. Owing to the large number of sovereigns introduced into the districts of Tanjore, Tinnevely, and Madura, partly received in payment of rice exported to Ceylon and the Mauritius, current silver money became so scarce in 1858 that it was difficult for the landowners to pay the revenue due by them. The Government of Madras, therefore, authorised the receipt of sovereigns at the Tanjore Treasury at 10 rupees each, and afterwards directed that they should be paid at the same rate to such persons as might be willing to receive them. Although this proceeding was over-ruled by the Government of India, it had gone far enough to prove that a gold currency, based upon the sovereign at 10 rupees, would rapidly have taken the place of the silver currency, if the Supreme Government had not interfered to prevent it.....

VIII.

STABILITY OF INTERNAL PRICES.

In my *Essays on Indian Economic Problems, Part I*, published in 1922, I wrote:—

"It has been argued in Chapter V that the most important cause of the rise of prices between 1905 and 1912 was the re-

*East India (Gold Currency). Copy of a Resolution, No. 1325, dated Simla, 12th July 1864, by the Government of India, Financial Department, on the subject of a Gold Currency for India, together with the several Minutes, Letters, etc., therein referred to; and of correspondence between the Secretary of State for India and the Government of India, relative to the same subject. Ordered by the House of Commons to be printed, 28 February 1865. No. 79. For Appendix A see page 5, and for Appendix B pp. 76-78.

dundancy of the rupee currency. The relation of the gold exchange system to prices has not hitherto received the attention which it deserves. It is very often assumed that since the gold exchange system ensures a stable exchange (the price of silver remaining steady), it satisfies all the requirements of an ideal monetary system. 'The establishment of the gold value of the rupee on a stable basis,' wrote the Chamberlain Commission, 'has been, and is, of the first importance to India.' But stability of exchange is not of the first importance even for trade. The thing which is really of the first importance to India is whether her currency system works automatically so that the currency does not tend to become inflated, and whether the people can get the form of money which they desire both for internal use and for export.

"Under the existing system notes are convertible into rupees, but rupees are not convertible into gold except for a very limited purpose—payment of foreign indebtedness. The whole mass of Indian currency consisting of rupees and notes may be regarded as inconvertible. In this sense, the rupee is little better than the paper note; the rupee is a note printed on silver. . . The internal currency, under a gold exchange system, might well consist exclusively of notes, which may be convertible at a fixed rate into gold for foreign payments. But the great danger of an inconvertible currency, or a currency which is convertible only to a limited extent, is that it tends to be over-issued. Can it be doubted that if our circulation consisted exclusively of notes which were convertible into gold for making foreign payments, but not for internal use, the currency would become redundant, even if additions to the circulation were made as under the existing system, *i.e.*, through the conversion of gold or Council bills imported, into notes? . . . It has been explained in a preceding Chapter that the forces tending to reduce the volume of the circulation in a gold exchange system do not, and cannot, work smoothly. The only remedy against inflation lies in the maintenance of convertibility of the internal currency for all purposes" (pp. 298-300).

Little did I dream when I wrote this that a Royal Currency Commission, sitting four years later, will recommend a

currency system for India which will carry her "very far along the road towards" the "ideal end"—a token currency of notes inconvertible for internal purposes. For reasons which are explained below I do not regard such a currency, in the circumstances in which we are placed, as the "ideal end towards which India should work."

I have explained in a preceding Chapter that there is no essential difference between the gold exchange system and the gold bullion standard—the essential feature of both is that gold does not circulate in the country but the internal currency, consisting of notes or token rupees, or both, is convertible into gold for the payment of international indebtedness. I have also shown that while *in theory* the token currency under the gold bullion standard will be convertible into gold bullion for *all* purposes, *in practice* the gold reserves of the Reserve Bank will be employed chiefly for the conversion of the token currency into gold for monetary purposes—that is, for the maintenance of the external value of the rupee.

It is not necessary to explain that the circulation is not contracted when the general public buys gold in the bazar. Under the gold bullion standard, as under the gold exchange system, rupees will be withdrawn from the circulation only when the balance of trade turns against the country and gold has to be shipped abroad.

Our Currency Commissioners have assumed that there will be no need to contract the circulation except when the internal depreciation of the monetary unit produces external depreciation. In para. 116 of the Report they state:—

"A rise of internal prices (that is a fall of internal purchasing power of the monetary unit) relative to the world level of gold prices, will inevitably impede exports and stimulate imports, and cause the balance of foreign payments to be upset, and with it the exchanges. An internal depreciation of the monetary unit does very soon produce external depreciation."

When this happens, the Reserve Bank's obligation to sell gold will become effective.

But our experience of the working of the gold exchange system from 1905 to 1914 has shown that it is possible for the

internal purchasing power of the monetary unit to decrease heavily (our prices were rising in this period more rapidly than world prices) while the external purchasing power remains stable (or is kept stable by artificial means). The view that "internal depreciation of the monetary unit very soon produces external depreciation" is essentially wrong. I cannot do better than quote here what I wrote on this subject in 1922:—

"It may be here emphasized that economic forces which tend to contract the circulation and lower prices never work so smoothly and automatically as is generally supposed. The classical theory of the distribution of precious metals through changes in prices has certainly the merit of simplicity. 'The amount of money needed by a country,' says General Walker, 'is that amount which will keep its prices (after allowance is made for the cost of transporting goods) at a level with those of the countries with which it has commercial relations.' This is the old Ricardian doctrine. It contains an important element of truth, but it ignores economic friction. It is generally recognised among economists that this theory, stated baldly and without qualification, as Ricardo stated it, is not true. Trade balances are not ordinarily adjusted by the exportation of specie. Very often the necessity of shipping gold or importing gold is avoided by readjustment in the prices of exports and imports; a number of devices are also employed for preventing or lessening the flow of gold from a country with an adverse balance. Lastly, the export of gold from a country, when it does take place, may make such an infinitesimally small addition to the world's gold circulation, that the effect upon the world's price level may be *nil*.

"The Ricardian theory, as Professor Kinley says, is 'too simple and sweeping.'* And if the flow of gold under the influence of changes in prices is not immediate and complete, it is possible that a country 'may for a time hold its supply of money at a level relatively higher than that of the world at large, and during that time many consequences of great importance to individuals and classes may occur because of the difference in level.'

**Money* by Kinley p. 95.

" According to the classical theory gold is imported or exported, and the amount of the circulating medium increases or decreases, according as the level of prices in a country is lower or higher than the world's price level. But it is easy to show that the inflow or outflow of gold has generally no appreciable effect on the export and import of goods. Apologising for introducing evidence on so simple a point, Laughlin shows that while prices in the United States were rising from 1878 to 1883, instead of a falling off in the value of exports there was an advance. ' Indeed, instead of a restriction of exports because of the imports of gold there was a heavy excess of exports over imports of goods during the whole period.'* In the case of our own country, the average annual imports of treasure (net) in the quinquennium 1909-1910 to 1913-14 amounted to £25,919,000 as compared with £17,503,000 for the quinquennium 1904-05 to 1908-09, and yet prices were higher in the former quinquennium.

" It thus appears that if a country's currency consists of token coins which are convertible into gold only for the payment of international indebtedness, and if the balance of trade is in the country's favour, so that the supply of tokens constantly increases, in time the currency may become redundant. In the long run, of course, the rise of prices would lead to the exportation of the excess currency and prices must fall, but the long run may prove to be a very long run indeed, and in the meantime, because of the depreciation of money, important consequences may occur to various classes of the community."**

The great disadvantage of a system of money in which the currency consists of token coins or notes, convertible into gold only for payments abroad, is that some of the causes which tend to lower prices by reducing the volume of circulation under gold or silver monometallism, cease to work under a system of limited convertibility.

When the rupee was a full value coin it was freely exported as bullion, it was melted down to make ornaments and it was also hoarded. The rupees in the hoards or in the form of orna-

**Principles of Money*, p. 374.

***Essays on Indian Economic Problems*, Part I, pp. 111-114.

ments represented the savings of the people. The rupees melted and hoarded formed a considerable proportion of the coinage. Mr. Atkinson estimates that from 1835 to 1862, 34 1/2 per cent. of the coinage of 1835 (five years) and 1840 (twenty-two years) was melted down into ornaments, and that the rupee consumption of the 1862-92 coin for ornaments was 40 crores, which is about 20 per cent. of the total coinage of 1862-92. As to rupees hoarded in the period 1862-92, taking 24 per cent of the coinage to have been hoarded, the amount would be 49 crores of rupees, equal to 157 lakhs a year.* Hoarding and melting, apart from export, accounted for about 45 to 50 per cent of the coinage.

The chief merit of the gold currency standard is that the amount of the currency under this system automatically adapts itself to the actual needs of the community. It is not meant that under the gold bullion standard the currency authority will force inconvertible notes upon the people, any more than the Government forced rupees or notes into circulation under the gold exchange standard. But a token currency, when it is not fully convertible for all purposes into legal tender coins of full value, tends to accumulate in circulation. In time its quantity becomes too great and prices rise. The internal purchasing power of the monetary unit decreases, which later on will affect the external purchasing power, but neither immediately, nor very soon.

It is thought that the Reserve Bank will be able to keep the internal value of the rupee stable by following "a judicious policy of limiting the monetary circulation to the actual needs of the country by an appropriate credit policy" (para 115). It is well known that the credit policy of the Bank of England and the joint stock banks in England has an important effect upon the internal value of money in the United Kingdom. This is because of the large amount of business which is transacted in the United Kingdom by means of credit instruments, and of the exceedingly important part that banks play in the commercial life of the country. The case of India is different. Banking here is in its

*Journal of the Royal Statistical Society, Vol. LXXII, p. 547.

infancy, and the use of credit instruments created by the banks is very limited in extent. So far as the present writer is aware, the changes in the rate of discount of the Imperial Bank have very little effect in augmenting or reducing the internal value of the monetary unit (*i.e.*, lowering or raising prices) at the present time, and there is really not much ground for thinking that the creation of the Reserve Bank with the sole right of note issue, will so revolutionise the methods of doing business in India, that the Bank will be able to regulate prices throughout the country by means of its credit policy.*

*90 per cent. of the people live in villages where there are no banks.

PART II

THE RATE OF EXCHANGE

I

ADJUSTMENT OF RUPEE PRICES TO THE RATE OF EXCHANGE.

Even a superficial study of the Currency Report would show that one of the main reasons for the recommendation of the Currency Commission that the rupee should be stabilized in relation to gold at a rate corresponding to an exchange rate of 1s. 6d. for the rupee is "that, at the present exchange rate of about 1s. 6d., prices in India have attained a substantial measure of adjustment with those in the world at large" (para. 176).* The Government also have accepted this view.**

The argument of our Currency Commissioners may be summarised as follows:—

In 1923 and the first half of 1924, when the exchange was fairly steady at about 15d. gold, movements of world prices and of Indian rupee prices roughly corresponded, "but from October 1924 to September 1925 there was a rapid and violent downward movement of the rupee price level which was not the reflection of any similar movement in world prices" (para. 186). The Currency Commissioners insist that "the marked fall in rupee prices *in the first half of 1925* represented largely the tendency of these prices to adjust themselves to the rise in exchange, the greater part of which had occurred in the preceding half year" (para. 187; italics mine).

*" We shall proceed to discuss a number of relevant issues which have been raised in this connection, and we shall examine the question from various angles; but we wish to make it clear at the outset that the central, and as it seems to us the decisive, factor is the extent to which the prevailing rate of exchange is reflected in internal prices. We are unanimous in holding the view—and, indeed, it is a proposition which it would be difficult to controvert—that, if it can be shown that prices have to a preponderant degree adjusted themselves to the existing *de facto* rate, then that rate must be adhered to. The further proposition, that such substantial adjustment has been secured, is a question of fact, as to which we shall now adduce the evidence on which our conviction is based" (para. 177).

**" Even the author of the Minute of Dissent admits categorically, in unanimity with the Commission as a whole (paragraph 177) that if prices in India have to a preponderant degree adjusted themselves to the 1s. 6d. ratio, that rate must be adhered to. I do not myself think that there is any valid argument to-day in favour of any other ratio...." (Sir Basil Blackett's speech in introducing the Currency Bill).

If it can be shown that the heavy fall in rupee prices which is thought to have occurred between October 1924 and September 1925 was largely illusory, and the fall in rupee prices which actually did occur in the first half of the year 1925 was in sympathy with the fall in gold prices, there would be reasons for doubting whether our prices have become adjusted to the exchange rate of 1s. 6d., and the case for the stabilization of exchange at this rate would be considerably weakened.

Our Currency Commissioners have used two series of index numbers of prices for India, index numbers of wholesale prices in Calcutta (Commercial Intelligence Department) and index numbers of wholesale price in Bombay (Bombay Labour Gazette). The general trend of both series of index numbers is the same, as will be seen from the table given below :—

Index Numbers of Wholesale Rupee Prices.

	Calcutta	Bombay
October 1924	181	181
November ..	180	176
December ..	176	176
January 1925	171	173
February ..	172	173
March ..	168	171
April ..	169	165
May ..	164	164
June ..	157	160
July ..	160	158
August ..	157	160
September ..	158	157

I readily admit that these index numbers show a heavy fall in rupee prices at a time when exchange was rising to 18d. gold. Between October 1924 and September 1925 the Calcutta index number fell 23 points, and the Bombay index number 24 points.

What are, then, my grounds for thinking that the heavy fall in rupee prices in the year 1925 was largely illusory?

The index numbers of wholesale prices in Calcutta and Bombay, owing to the use of the arithmetic average, much exaggerate the fall of prices.

The method of constructing the index numbers, in each case, is the same—the unweighted arithmetic average is used, and certain important commodities have been indirectly weighted by securing quotations for more than one grade of such commodities. The Bombay general index number is an average of the index numbers of the prices of about 43 articles, and the Calcutta index number, of about 75 articles.

The arithmetic average is very commonly employed, but it is well known to students of statistics that it “exhibits an *inherent tendency* to exaggeration.” It is “distinctly *baised*” (italics in both cases Fisher’s).* The comment of Irving Fisher, perhaps the greatest authority on index numbers, on the utility of the simple arithmetic average, may be quoted here:

“In the present exposition, the simple arithmetic average is put first merely because it naturally comes first to the reader’s mind, being the most common form of average. But we shall see that the simple arithmetic average produces one of the very worst of index numbers. And if this book has no other effect than to lead to the total abandonment of the simple arithmetic type of index number, it will have served a useful purpose.”**

No better illustration of the unreliability of the simple arithmetic average as a guide in the measurement of a rise or fall of prices can be given than is furnished by the index numbers of wholesale prices in Bombay.

In what follows, I am obliged to take the index numbers for Bombay (Bombay Labour Gazette) as the basis of discussion. The Calcutta index numbers have been published by groups of articles. The index numbers showing the rise or fall in the prices of individual articles which enter into the general index number, have not been published. It is therefore not possible to know which prices fell and which rose while the general index number fell 23 points between October 1924 and September 1925. But it should be remembered that the movement of wholesale prices

**The Making of Index Numbers* by Irving Fisher, 1922, pp. 86-87.

***Ibid.* pp. 29-30.

in Calcutta and Bombay during this period was similar, and that prices in Bombay fell one point more than prices in Calcutta.

The index numbers of wholesale prices in Bombay for October 1924 and September 1925 are given below:—

Wholesale Market Prices in Bombay.

Index Numbers. Prices in July 1914=100.

Article.	Grade.	Oct. 1924.	Sept. 1925.
Cereals—			
Rice	.... Rangoon Small-mill	.... 147	137 F
Wheat	.... Delhi No. 1	.... 147	149 R
..	.... Khandwa Seoni	.... 156	158 R
..	.... Jubbulpore	.... 131	139 R
Jowari	.... Cawnpore	.... 121	131 R
Barley	.....	.... 145	135 F
Bajri	.... Ghati	.... 139	152 R
Pulses—			
Gram	.... Punjab yellow (2nd sort)	.... 95	105 R
Turdal	.... Cawnpore	.... 94	103 R
Sugar—			
Sugar	.... Mauritius No. 1	.... 206	....
"	.... Java, white	.... 193	145 F*
Raw (gul)	.... Sangli or Poona	.... 190	164 F*
Other food—			
Turmeric	.... Rajapuri	.... 454	180 F*
Ghee	.... Deshi	.... 181	194 R
Salt	.... Bombay (black)	.... 153	153 S
Oilseeds—			
Linseed	.... Bold	.... 161	145 F
Rapeseed	.... Cawnpore (brown)	.... 163	144 F
Poppy-seed*	.....	.... 136	125 F
Gingelly	.... White	.... 154	131 F
Textiles—			
Cotton—			
(a) Cotton raw—			
Broach	.... Good	....	....

Article.	Grade.	Oct. 1924.	Sept. 1925.
Oomra	Fully good	248	184 F*
Dharwar	Saw-ginned	—	—
Khandesh	Machine-ginned	266	—
Bengal	Do.	267	—
(b) Cotton manufactures—			
Twist	40s	227	188 F*
Grey Shirtings	Fari 2,000	217	194 F
White mulls	6,600	206	257 R
Shirtings	Liepmann's 1,500	241	219 F
Long cloth	Local made 26"×37½ yds.	231	192 F*
Chaddars	54"×6 yds.	216	181 F*
Other textiles—			
Silk	Manchow	172	149 F
"	Mathow Lari	183	160 F
Hides and Skins—			
Hides, cow	Tanned	160	148 F
" buffalo	"	103	75 F*
Skins, Goat	"	205	200 F
Metals—			
Copper braziers	.....	106	103 F
Iron bars	.....	175	175 S
Steel hoops	.....	152	142 F
Galvanised sheets	.....	174	156 F
Tin plates	.....	229	189 F*
Other raw and manufactured articles—			
Coal	Bengal, 2nd Class Steam	160	155 F
"	Imported	123	124 R
Kerosene	Elephant Brand	175	170 F
"	Chester Brand	185	185 S
General Index No—			
Arithmetic average	.....	181	157
Geometric Mean	.....	172.21	153.46

(Bombay Labour Gazette.)

R=Rise of price. S=Stationary price. F=Fall of price.
F*=Fall of more than 24 points in price.

Of the 39 articles included in the general index number for September 1925, 10 rose in price, 3 remained stationary, while the remaining 26 fell in price.

Of the 26 articles which fell in price, the prices of 16 fell to an extent smaller than that of the fall in the general average; the prices of 9 fell more heavily than the general average, while in one case (sugar raw) the fall in price was equal to the fall in the general average.

Of the 9 articles which fell heavily in price, the fall in the price of sugar (Java white), turmeric and raw cotton (Oomra) was as follows:—

Sugar, Java white	48 points.
Cotton Oomra	64 ..
Turmeric	274 ..

It should be clear that the heavy fall in rupee prices as shown by the Bombay index numbers is confined to a small number of articles—9 out of a total of 39 articles. The influence of the heavy fall in the price of a single article in exaggerating the fall in general prices, when the arithmetic average is used in the construction of index numbers, is shown by the fact that if turmeric is excluded, the general index number for October 1924 falls from 181 to 174, while the index number for September 1925 remains practically unaffected (156.7). The exclusion of turmeric reduces the fall in the general index number from 24 points to 17—or a large part (approximately a third) of “the rapid and violent downward movement” in rupee prices between October 1924 and September 1925 disappears if 41 instead of 42 articles are taken as the basis of the general index number for October 1924.

The arithmetic average is too much affected by extreme deviations from the average. The geometric mean gives less weight to extreme deviations than the arithmetic mean, and “It is particularly well adapted to the averaging of ratios of price change.”* It is not only desirable but necessary that the most,

**Statistical Methods*, by F. C. Mills (1925), p. 145.

and not the least, satisfactory average should be used in measuring price changes, when the extent of price changes is to be used as an argument for stabilizing exchange at a particular rate.

It is not clear to me why the Currency Commissioners have chosen October 1924 as the base for price comparisons. The average rate of exchange (average of daily rates) in October 1924 was 1s. 6d. sterling, equal to more than 15d. gold. In April 1924 the average rate of exchange was 1s. 4 $\frac{3}{4}$ d., equal to about 15d. gold. Between April 1924 and September 1925 exchange rose from 15d. to 18d. gold, or 20 per cent. To what extent did Indian prices rise in this period?

The table given below shows the index numbers of wholesale prices in Bombay in April 1924 and September 1925:—

[TABLE.]

WHOLESALE MARKET PRICES IN BOMBAY.

Index Numbers. Prices in July 1914=100.

Article.	Grade.	April 1924.	Sept. 1925.	Price in Sept. 1925 as a per- centage of the price in April 1924.
Cereals.—				
Nice	..... Rangoon Small-mill	134	137	102 R
Wheat	..... Delhi No. 1	116	149	128 R
"	..... Khandwa Seoni	140	158	113 R
"	..... Jubbulpore	123	139	113 R
Jowari	..... Cawnpore	117	131	112 R
Barley	.....	106	135	127 R
Bajri	..... Ghati	119	152	128 R
Pulses.—				
Gram	..... Punjab yellow (2nd sort)	77	105	138 R
Turdal	..... Cawnpore	90	103	114 R
Sugar				
Sugar	..... Mauritius No. 1	278	—	—
"	..... Java, white	245	145	59 F*
Raw (gul)	..... Sangli or Poona	129	164	127 R
Other food.—				
Turmeric	..... Rajapuri	500	180	36 F*
Ghee	..... Deshi	188	194	103 R
Salt	..... Bombay (black)	149	153	103 R
Oilseeds.—				
Linseed	..... Bold	135	145	107 R
Rapeseed	..... Cawnpore (brown)	121	144	119 R
Poppy seed	.....	112	125	112 R
Gingelly	..... White	139	131	95 F†
Textiles. Cotton.—				
(a) Cotton, raw—				
Broach	..... Good	233	—	—
Oomra	..... Fully good	255	184	72 F*
Dharwar	..... Saw-ginned	—	—	—
Khandesh	..... Machine-ginned	271	—	—
Bengal	..... Do.	272	—	—
(b) Cotton manufactures.—				
Twist	..... 40s	239	188	78 F*
Grey Shirtings	..... Fari 2,000	236	194	82 F*
White mulls	..... 6,600	209	257	123 R

Article.	Grade.	April 1924	Sept. 1925.	Price in Sept. 1925 as a per- centage of the Price in April 1924.
Shirtings	Liepmann's 1,500	275	219	80 F
Long cloth	Local made 36"X37 $\frac{1}{2}$ yds.	247	192	78 F*
Chaddars	54" X 6 yds.	218	181	83 F
Other textiles—				
Silk	Manchow	193	149	77 F*
"	Mathow Lari	265	160	60 F*
Hides and Skins—				
Hides, cow	Tanned	152	148	97 F†
buffalo	"	77	75	97 F†
Skins, goat	"	210	200	95 F†
Metals—				
Copper braziers		118	103	87 F
Iron bars		175	175	100 S
Steel hoops		145	142	98 F†
Galvanised sheets		179	156	87 F
Fish plates		229	189	83 F
Other raw and manu- factured articles—				
Coal	Bengal, 2nd Class Steam.	167	155	93 F
"	Imported	163	124	76 F*
Kerosene	Elephant Brand	166	170	102 R
"	Chester Brand	185	185	100 S
General Index No. —				
Arithmetic average		184	157	85
Geometric Mean		170.16	153.46	90.18

R=Rise of price. S=Stationary price. F=Fall of price.
F*=Fall of price exceeding 20 per cent. F†=Fall of
price not exceeding 5 per cent.

The general index number (geometric mean) fell from 170.16 in April 1924 to 153.46 in September 1925, a fall of about 10 per cent as compared with a rise of 20 per cent in exchange. If sugar (Java white), turmeric and silk (Mathow Lari) are excluded, the general index number fell from 162.33 in April 1924 to 152.85 in April 1925, a fall in general prices of about 6 per cent.

Further, the index numbers of the different articles do not show a general tendency towards a fall.

Out of 39 articles, no less than 17 rose in price, while the price of 2 remained stationary (iron bars and kerosene, Chester Brand). In the case of about half the total number of articles included in the general index number it would be absurd to talk of adjustment of prices to exchange.

Out of the remaining 20 articles, only in the case of 8 did the fall in price exceed 20 per cent. The price of Cotton Shirtings fell 20 per cent. Of the remaining 11 articles whose price fell less than 20 per cent, in 5 cases the fall in price did not exceed 5 per cent.

The articles whose price fell more than 20 per cent are the following:—

	Per cent.
Sugar, Java white	41
Turmeric	64
Cotton raw-Oomra	28
Cotton manufactures-Twist	22
„ „ Long cloth	22
Silk, Manchow	23
Silk, Mathow Lari	40
Coal	24

The case of turmeric is exceptional. The price of turmeric per maund was Rs. 5-9-3 in July 1914, Rs. 31-4-8 in January 1923 and Rs. 39-11-8 in December 1923. The index number for turmeric rose to 712 in December 1923* (July 1914=100), after

*The exclusion of turmeric lowers the general index number for December 1923 from 188 to 175, or by 13 points (arithmetic average).

which a rapid fall set in. Within less than a year the index number had fallen to 454 (October 1924) and in September 1925 it stood at 180.

The fall in the price of sugar (Java white) and cotton, raw and manufactures, is due to world causes.

The gold price of sugar was already falling in 1924; it fell further in 1925. The abundant cotton crop in the United States lowered the gold price of raw cotton in 1925.

The London price of sugar (Java white) and American cotton G. O. in April 1924 (average of weekly quotations as reported in the *Statist*) was as follows:—

	April 1924.	Sept. 1925.	Fall of price in Sept. 1925 as compared with April 1924. Per cent.
Sugar (Java white), c.i.f. per cwt.	26/9	16/0	40
American Cotton. G. O., per lb.	16.01d.	11.28d.	30

This fall in price is not explained by the rise in the gold value of the £ sterling between April 1924 and September 1925. In April 1924 the £ sterling was about 11 per cent below its gold parity.

The gold price of silk, on the whole, tended to rise in the world's markets in 1925, and the heavy fall in the price of silk in India must be due to causes peculiar to India.*

The causes of the fall in the price of Indian coal are well known. According to the Report of the Tariff Board on Coal, the fall in price in 1924 and 1925 was due to an over-rapid development of the industry. The causes of the fall in price are not connected with the rise in exchange but "the excess of production over demand."**

It is obvious that when the price of a commodity falls at a time when exchange is rising, it is wrong to infer that the fall in

*It may however be noted that the price of Silk, Common, New Style, per lb. in London in April 1924 (average of weekly quotations as reported in the *Statist*) was 25 3/4 and in September 1925, 17/6—a fall in price of 32 per cent.

**Tariff Board's Report on the grant of protection to the Coal industry, 1926, p. 24.

price *must* be due to the rise in exchange. We have seen that the fall in the price of sugar and cotton in 1925 was due to world causes, and that the fall in the price of Indian coal was due to over-production. Turmeric has been falling in price since December 1923, and the great extent of the fall makes it certain that it is not due to the comparatively small rise in exchange.

The Bombay Labour Office has also constructed a special series of index numbers of wholesale prices in Karachi. These index numbers have been ignored by the Currency Commissioners:—

[TABLE.

WHOLESALE MARKET PRICES IN KARACHI.

Index Numbers. Prices in July 1914=100.

Article.	Grade.	April. 1924	Sept. 1925
Cereals.—			
Rice	Larkana, No. 3	126	156
Wheat, white	5% barley, 3% dirt, 30% red	113	138
Wheat, red	5% barley, 3% dirt, 92% red	111	136
" white	2% barley, 14% dirt.	112	138
" red	2% barley, 14% dirt.	111	136
Jowari	Export quality	104	157
Barley	3% dirt.	104	125
Pulses.—			
Gram	1% dirt.	86	115
Sugar.—			
Sugar	Java white	241	157
"	Java brown	—	—
Other food.—			
Salt	—	78	79
Oilseeds.—			
Cotton seed	—	148	125
Rapeseed	3% admixture	125	141
Gingelly	Black 9% admixture	—	137
Textiles.—			
Jute bags	B. Twills	146	182
Textiles. Cotton.—			
(a) Cotton, raw	—	—	—
Sind	—	285	211
(b) Cotton manu- factures	—	—	—
Drills	Pepperill	294	205
Shirtings	Liepmann's	267	217
Yarns	40s Grey (Plough)	—	—
Other Textiles.—			
Wool	Kandhar	152	168
Hides.—			
Hides, dry	Sind	85	64
" "	Punjab	85	64

Article.	Grade.	April 1924	Sept. 1925
Metals.—			
Copper Braziers		122	113
Steel Bars		174	168
D. Plates		183	163
Other raw and manu- factured articles.—			
Coal	1st. Class Bengal	219	144
Kerosene	Chester Brand	183	183
Do.	Elephant do	161	165
General Index No.—			
Arithmetic Average.—		153	146
Geometric Mean		141.33	139.63

(Bombay Labour Gazette.)

The Karachi figures show a fall in the general index number (geometric average) from 141.33 in April 1924 to 139.63 in September 1925, a fall of 1.2 per cent as compared with a rise of 20 per cent in exchange.

The Currency Commissioners insist that the fall in rupee prices between October 1924 and September 1925 "was not the reflection of any similar movement in world prices." But if the index numbers of Indian prices are compared with the index numbers of English prices, it is seen that the fall in rupee prices in that period was in sympathy with the fall in English prices. The following table shows the index numbers of Indian and English prices from October 1924 to September 1925:—

[TABLE.]

Wholesale rupee and sterling prices.

	Indian Prices (Bombay Labour Gazette, for Bombay) July 1914=100		Prices in the United Kingdom (Board of Trade) 1913=100
No. of articles.	43		150
	Arith. Average.	Geom. Average.*	
Oct. 1924	181	172	170
Nov. „	176	167	170
Dec. „	176	170	170
Jan. 1925	173	165	171
Feb. „	173	168	169
March „	171	165	166
April „	165	163	163
May „	164	160	159
June „	160	156	158
July „	158	153	158
Aug. „	160	157	157
Sept. „	157	153	156

It is important to remember that these index numbers can be compared only in regard to the general movement of prices which they indicate. No argument as regards the extent of the fall of prices in India and the United Kingdom can be based on them as (1) their methods of construction are different, (2) the number of articles included in them are different, and (3) the basic periods are different.

*See Appendix C at the end of this Chapter.

If the index numbers of the Board of Trade may be trusted as a guide to the study of the general movement of prices in the United Kingdom between October 1924 and September 1925, they show an unmistakable tendency towards a fall in this period. This is also the meaning of the Indian index numbers. It cannot be said that the fall in Indian prices took place at a time when English prices were stationary.

The English index numbers given above are index numbers of sterling prices. What is the relation of our rupee prices to gold prices?

The world gold prices for our Currency Commissioners mean the average of English prices (Board of Trade) converted into gold and gold prices in the United States (Bureau of Labour). They have neglected the rest of the world.

The course of gold prices in the United States and in European countries in 1925 has not been the same. While prices in the United States remained fairly steady, gold prices in Europe fell appreciably. An average of price index numbers of the Board of Trade and the Bureau of Labour (United States) is misleading. To obtain a general view of *world* gold prices we must study the movement of gold prices in the more important countries of the world.

The following table shows the index numbers of wholesale gold prices in 1925 in the United States and 14 countries of Europe:—

[TABLE..

**International Index Numbers of Wholesale Prices in
Gold. (1913-14=100).**

(The figures have been calculated in the case of each country with
reference to pre-war prices; they are comparable only
in regard to their movement.)

	Year 1925.											
	Jan.	Feb.	March	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Germany, Stat. B. A.)	138	137	134	131	132	134	135	132	126	124	121	122
Great Brit.— (Board of Tde.)	168	166	163	161	159	158	158	157	156	154	153	152
France— (Stat. Gen.)	144	138	140	139	135	130	136	136	136	125	121	121
Belgium— (Min. d. L'Ind. et du Trav.)	150	143	145	141	137	131	134	133	130	135	133	133
Netherlands— (Centr. Bur. v. d. Stat.)	161	159	151	150	151	153	155	155	155	154	154	155
Denmark— (Finanstid)	156	152	151	150	151	153	163	156	147	146	148	145
Sweden— (Komm. Koll)	170	170	169	164	162	161	161	159	157	154	155	156
Norway— (Oek. Rev.)	159	160	159	163	161	165	175	178	179	168	165	165
Switzerland— (Loranz)	171	170	166	163	162	162	161	160	159	157	157	155
Italy— (Bachi)	142	141	139	140	137	131	134	142	152	147	149	151
Spain— (Inst. Geogr. y Estadist)	140	141	142	141	144	141	141	137	138	139	137	137
Austria— (Stat. Nachr.)	143	148	144	140	139	143	138	132	128	128	125	125
Czecho-Slovakia— (Stat. Staatsamt)	152	150	148	147	145	147	145	145	144	142	142	141
Poland— (Official)	20	121	122	119	118	119	120	107	110	109	104	88
United States of America— Bur. of Labour	160	161	161	153	155	157	160	160	160	158	158	156

Wirtschaft und Statistik, Berlin, (published by the Government
Statistical Department), 1 Feb. Heft 1926. p. 84.

The index number of the United States for September was the same as that for January. But in 12 out of the 14 countries of Europe prices in September 1925 were lower than in January. The extent of the fall in different cases was as follows:—

Fall in gold prices in September 1925 as compared with January 1925

Germany	12 points.
Great Britain	12 "
France	8 "
Belgium	20 "
Netherlands	6 "
Denmark	9 "
Sweden	13 "
Switzerland	12 "
Spain	2 "
Austria	20 "
Czecho-Slovakia	8 "
Poland	10 "

The index number of Norway in September shows a rise of 20 points, and of Italy 10 points. The average of the index numbers of the 14 countries of Europe fell from 151 in January to 145 in June and to 144 in September. In December prices in Europe were about 10 per cent below the level of prices in January.

The explanation of the fall in European gold prices in 1925 is "increasing economic stagnation in most of the European countries"* in contrast to the favourable conjuncture in the United States. Prices had been rising in the year 1924, and the rise of prices was partly speculative. The fall of prices in 1925 was in some measure due to a reaction against inflated prices, and mainly to increased production. The revival of trade in the United States raised prices in the month of July in that country to the level of January, but "increasing depression"* in Europe continued to lower prices in the great majority of European countries.

In December 1925, as compared with December 1924, the world prices of the great majority of commodities had fallen. This is shown by the following table:—

**Wirtschaft und Statistik*, 1 February Heft 1926, pp. 84-85.

Rise (+) or fall (-) in price
in Dec. 1925 as compared
with Dec. 1924. Per cent.

Wheat	.....	+ 1
Rye	.....	- 25
Barley	.....	- 24
Oats	.....	- 2
Maize	.....	- 12
Beef	.....	- 9
Mutton	.....	- 11
Pork	.....	+ 31
Lard	.....	- 11
Tallow	.....	- 9
Butter	.....	- 18
Linseed oil	.....	- 21
Rapeseed	.....	- 3
Rapeseed oil	.....	- 4
Sugar	.....	- 23
Coffee	.....	- 15
Tea	.....	- 12
Cocoa	.....	- 9
Tobacco	.....	+ 3
Hides	.....	- 1
Leather	.....	- 10
Cotton	.....	- 21
Wool	.....	- 29
Silk	.....	+ 8
Jute	.....	+ 57
Hemp	.....	- 16
Flax	.....	- 39
Rubber	.....	+189
Iron	.....	- 16
Copper	.....	- 3
Zink	.....	+ 8
Tin	.....	+ 12
Lead	.....	- 12
Coal	.....	- 10
Petroleum	.....	- 5
Saltpetre	.....	- 2

(These figures are based on English prices converted into gold, except in the case of rye and sugar, for which New York quotations were used. *Wirtschaft und Statistik*, 1 February Heft 1926, p. 87).

Such has been the course of the world gold prices during the year 1925. It is seen that the downward movement of the rupee from January to September 1925, was the reflection of a similar movement not only in English, but European gold prices.

The general conclusions suggested by the foregoing discussion may be summarised as follows:

1. A very large part of the "rapid and violent downward movement of the rupee price-level" between October 1924 and September 1925 is due to the use of the arithmetic average which is distinctly biased and which has an inherent tendency to exaggeration. The exclusion of a single article of comparative insignificance—turmeric—reduces the general index number of wholesale prices in Bombay in October 1924 (arithmetic average) from 181 to 174.

2. Between April 1924 and September 1925 the exchange value of the rupee rose 20 per cent. Rupee prices in this period fell about 10 per cent. The prices of 36 articles fell about 6 per cent. In the case of about half the total number of articles (17 which rose in price, and 2 more whose price did not change) there was no adjustment on account of the rise in exchange. Only in a small number of cases (8) did the fall in price exceed the rise in exchange.

3. The fall which occurred in rupee prices from January to September 1925 was in sympathy with the fall in English and European gold prices.

It would thus seem that, on the basis of the information that is available, it is impossible to dogmatise, as the Currency Commissioners have done, about the adjustment of Indian prices to the rate of exchange; and if the proposal to stabilize the rate of exchange at 1s. 6d. gold rests mainly on this supposed adjustment, it obviously rests on a very weak foundation.

* * *

In a study of the price movement in relation to the exchange movement, it is always desirable to investigate the causes of the rise or fall in the prices of individual commodities. The rise or fall of prices is not always due to changes in the rate of

exchange, and even if the price of a commodity falls at a time when exchange is rising, the amount of the fall in price being equal to that of the rise in exchange, the causes of the fall may be wholly unconnected with the rise in exchange. Hence the importance of the study of price fluctuations in the case of individual commodities.

A detailed study of the movements of Indian prices from 1861 to 1891 was made in connection with the Indian currency reform of 1893.* The subject also attracted the attention of a foreign writer, Dr. Paul Arndt, whose work *Die Kaufkraft der Rupie*** may still be read with interest. At the very outset Dr. Paul Arndt says:—

“So far as the available material permits, I shall try to answer the question, whether the price level has risen within the 25 years in question (1870-95), for each important commodity separately; it will then become so much the easier to recognise the causes to which, on the whole, the fluctuations in prices are to be ascribed” (italics Dr. Arndt’s).***

Similarly, O’Conor, in his paper on Prices, written in 1892, undertakes a detailed examination of the fluctuations in the prices of articles of import and export, and of wholesale as well as retail prices.

This is the only right and proper method of investigation in such a case. It is most remarkable that the Royal Currency Commission of 1926 should have recommended the stabilization of the rate of exchange at 1s. 6d., mainly on the ground that Indian prices have become adjusted to the rate of exchange, without having considered whether in the case of the larger number of the more important commodities such adjustment has taken place. The Currency Report does not contain a single reference to the price of any article, whether of import or export.

The evidence on which we are asked to believe that the adjustment of rupee prices to the 1s. 6d. rate is complete, is worthless. It is no evidence at all.

I have examined the fluctuations in the prices of about 43 commodities included in the general index number of wholesale

*Papers relating to Changes in the Indian Currency System, Simla, 1893 pp. 31-52.

**Tuebingen, 1897. Verlag der H. Laupp’schen Buchhandlung.

***Pages 12-13.

prices for Bombay. This is all the information that is available to a non-official writer. But it is insufficient. No definite and final answer can be given to the question of adjustment of prices to exchange without examining the statistics of prices, wholesale as well as retail, in each month of the last six years, of all important articles of import and export, for the major Provinces of India.

There is absolutely no reason why this information should not be made public some time before the discussion on the Currency Bill in the next Session of the Indian Legislative Assembly.

The reasons for a detailed study of Indian price movements are not less strong to-day than they were in 1892. The whole question of the adjustment of prices to the rate of exchange must be re-examined in the light of the remarks made above; the examination of the question by the Currency Commission is, in these circumstances, of next to no value.

Footnote to page 54.

Fall in the price of imported coal (24 per cent.)

The fall in the price of imported coal is due to general depression in the coal industry. The following figures (taken from the *Wirtschaftsdienst*, Hamburg) show the fall in the price of coal in the United Kingdom and Germany:—

Coal.	Beginning of April 1924.	Beginning of September 1925.	Fall in price per cent.
Newcastle, Best Coking coal (Durham) f. o. b. s. per ton	25	15	40
Cardiff, Best Bunker coal f. o. b. s. per ton	23	12/6	46
German, Coal, Fettfoederkohle, Gold Marks per ton	20.60	15	27

APPENDIX C

THE GEOMETRIC MEAN.

The geometric mean is the n th root of the product of n terms; its value therefore is represented by—

$$M_g = \sqrt[n]{a_1 \cdot a_2 \cdot a_3 \dots a_n}$$

The geometric mean is easily found with the help of logarithms:

$$\text{Log } M_g = \frac{\text{log } a_1 + \text{log } a_2 + \text{log } a_3 + \dots + \text{log } a_n}{n}$$

The logarithm of the geometric mean is equal to the arithmetic mean of the logarithms of the individual terms.

The geometric mean of the index numbers of wholesale prices in Bombay (Bombay Labour Gazette) for April 1924 and from October 1924 to September 1925 has been thus calculated:—

April 1924	—	Log M_g =95·9,267,285, divided by 43	
		=2·2,308,542.	∴ M_g = 170·16
Oct.	„	—	
		Log M_g =93·9,145,051, divided by 42	
		=2·2,360,597.	∴ M_g = 172·21
Nov.	„	—	
		Log M_g =91·1,724,083, divided by 41	
		=2·2,237,173.	∴ M_g = 167·39
Dec.	„	—	
		Log M_g =93·6,365,211, divided by 42	
		=2·2,294,409.	∴ M_g = 169·61
Jan.	1925	—	
		Log M_g =93·1,557,108, divided by 42	
		=2·2,179,931.	∴ M_g = 165·20
Feb.	„	—	
		Log M_g =93·4,712,590, divided by 42	
		=2·2,255,062.	∴ M_g = 168·08
March	„	—	
		Log M_g =95·3,901,601, divided by 43	
		=2·2,183,758.	∴ M_g = 165·34
April	„	—	
		Log M_g =90·6,624,824, divided by 41	
		=2·2,112,800.	∴ M_g = 162·66
May	„	—	
		Log M_g =90·4,154,908, divided by 41	
		=2·2,052,559.	∴ M_g = 160·42

June	.....	Log M_{θ} =89·9,265,786, divided by 41	
		=2·1,933,312.	$\therefore M_{\theta} = 156·08$
July	„	..... Log M_{θ} =87·3,995,623, divided by 40	
		=2·1,849,891.	$\therefore M_{\theta} = 153·11$
Aug.	„	— Log M_{θ} =87·8,101,103, divided by 40	
		=2·1,952,528.	$\therefore M_{\theta} = 156·77$
Sept.	„	..... Log M_{θ} =85·2,538,607, divided by 39	
		=2·1,859,964.	$\therefore M_{\theta} = 153·46$

II.

PAST EXPERIENCE.

have referred in the preceding Chapter to the study of Indian price movements in connection with the currency reform of 1893. The subject is interesting, and the conclusions of O'Connor may be quoted here as they throw some light on the general relation between exchange and prices.

The average rate of exchange in the year 1873 was 22.87d. per rupee, and in 1892, 15.25d.; the fall in exchange thus amounted to 33.3 per cent. To what extent did Indian prices rise in this period by way of adjustment to the fall in exchange?

The Government of India addressed a despatch* to the Secretary of State for India in August 1892 on the subject of Indian prices, enclosing O'Connor's paper on the range of prices in India. In paragraph 7 of the despatch the Government of India referred to the connection between prices and exchange as follows: "Your Lordship is no doubt aware that, although there must be a connection between the range of prices and the standard of value, it is in practice extremely difficult, if not impossible to trace the connection** The extent to which fluctuations of price are due on the one hand to such causes as the failure of crops or the apprehension of scarcity can never be determined with accuracy. The figures we have just given confirm this conclusion."

From the paper prepared by O'Connor and the price statistics quoted by him it appears that the wholesale prices of imports generally, as compared with 1873, had fallen in 1892 by 26 per cent in the case of cotton goods; from 36 to 43 per cent in the case of cotton yarns; 36 per cent in the case of iron and 28 per cent in the case of copper. The price of kerosene oil fell 24 per cent in the case of American oil and 19 per cent in the case of

*Papers relating to Changes in the Indian Currency System, Simla, 1893, p. 31.

**The Hon. J. L. Mackay, of Mackinnon Mackenzie and Co., owners of jute and cotton mills and general merchants' agents, in the course of his evidence before the Herschell Committee, thus referred to the connection between prices and exchange (Q. 1068): "...if you take the case of jute for instance, jute was Rs. 9 a maund last year, and this year, with exchange much lower, it is about 4. It is exceedingly difficult to trace the connection between the standard and prices. I am unable to do it."

Russian oil as compared with 1888 (no figures before 1888 available).

As regards exports, the position in 1892 as compared with 1873 was as follows:

Wholesale Prices in 1892 (1873=100).

<i>Articles.</i>	<i>Prices.</i>	<i>Articles.</i>	<i>Prices.</i>
Articles which fell in price:—*		Shellac, middling	95**
Cotton, Broach	75	Silk, raw Sardah	65
" Yarns 20 S.....	65	Articles which rose in price:—	
" T Cloth	77	Wheat, Bombay	118
Hides	66	" Calcutta	103
Indigo, good	74	Rice, Moonghy	162
Opium, Bengal	89	" Ballam	169
" Malwa	88	Linseed, Bombay	110
Tea, good Souchong	41	" Calcutta	112
Articles of minor importance which fell in price:—		Jute, picked	236
Saltpetre	85	" ordinary	231
		Gunny bags	132

*These articles represent 47 per cent of the average value of the exports of Indian merchandise in the five years ending 1892.
**A speculative trade with great fluctuations in price—67 in 1891.

O'Connor thus commented on the rise in the prices of these articles: "The general rise of price of these articles is due to special and exceptional reasons, and except as regards rice, it cannot be said that prices show any distinct tendency to a permanent rise. Generally it may be said that with the exception of rice (which has shown a distinct upward tendency since 1887) and jute, all the important staples of the export trade have either not increased or have fallen in price."*

I have recently made a detailed study of the relation between exchange and prices from 1873 to 1924.** As regards the period 1873-95, my conclusion, based on the index numbers of Indian prices (Statistical Department of the Government of India) is

*Papers relating to the Changes in the Indian Currency System, 1893, p. 35.

***Weltwirtschaftliches Archiv, Kiel*, for April 1926, pp. 247-292, *Exchange and Prices in India 1873-1924*.

that, on the whole, general prices in India rose very little as compared with the heavy fall in exchange.

The general movement of prices between 1871 and 1895 and the fall in exchange are shown by the following table:--

Fluctuations of exchange and General Movements of Prices 1871-95. (1873=100).

Quinquennia	Exchange	28 exported articles.	11 imported articles.	39 ^a articles.
1871—75	99.9	94	94	97
1876—80	88.4	107	87	102
1881—85	86.2	95	81	91
1886—90	75.5	99	87	95
1891—95	65.1	109	86	102

The heavy fall in exchange which took place in 1873-95 should have raised prices in India. The prices of imported articles, however, fell owing to the fall in gold prices; and it is difficult to ascribe the comparatively small rise in the prices of exported articles to the fall in exchange as it is probably accounted for by unfavourable agricultural conditions in India.

The index number of the retail prices of food grains** shows violent fluctuations in the whole period. As compared with 100 in 1873 it rose to 174 in 1878. Prices fell below the level of 1873 in 1881, and between 1881 and 1885 they fluctuated between 96 and 100. Scarcity in particular parts of the country raised the index number to 123 in 1888, and widespread scarcity and distress caused prices to rise to 148 in 1892. In 1894 the index number fell to 114, but it rose to 120 in 1895. It is evident that the prices of food grains, both wholesale and retail, were much influenced by scarcity conditions. The high level of food prices in the quinquennium 1891-95 was partly due to increased foreign demand for rice and wheat.

^aBased on index Numbers of Indian Prices, 1861-1918 (Department of Statistics, India), No. 996, Calcutta 1919.

**See Index Numbers of Indian Prices, 1861-1918 (1919), Summary Table III, p. 3.

We may sum up our conclusions regarding the relation between exchange and prices in 1873-95 as follows:—*

(1) Prices of imported articles fell with exchange

*Support is lent to these conclusions by a most interesting report on the "Depreciation of the Currency in Brazil, showing the effect on Prices and Wages," published as an appendix to the evidence taken before the Indian Currency Committee of 1898.

The lists of prices, in the words of the Report show "that the tendency is for prices neither to fall nor rise in proportion to the appreciation or depreciation of the currency." Again, "The prices of articles of consumption in the country which are also exported, depending on various influences, do not follow the fluctuations of exchange with regularity." General movements of exchange and prices are shown by the following figures:—

*Movements of Exchange and Prices in Brazil,
(Rise +, Fall—).*

Falling exchange.	Exchange per cent.	Average prices per cent.
1821—30	—55	+10
1835—44	—33	+less than 2
1840—44	—20	—11*
1889—97	—70	+55
1889—92	—52	+36
Rising exchange.		
1831—35	+36	—10
1843—47	+10	+10 4
1868—75	+33	—13
1885—89	+33	+5

*Prices of articles not exported.

**9 articles.

It is seen that during the period 1840-44 prices of articles not exported fell 11 per cent and the purchasing power of Brazilian currency in terms of these commodities increased while the external value of the currency fell 20 per cent. In periods of falling exchange prices generally rose, but the rise of prices was not in proportion to the fall in exchange. Further, if we consider individual articles of consumption and export, we find that price movements were irregular. For example, in 1821-30 while exchange fell 55 per cent and average prices rose 10 per cent, the price of coffee fell 43 per cent and of tobacco 12 per cent. In the next period, 1835-44, exchange fell 33 per cent and average prices rose less than 2 per cent, but the price of tobacco fell 24 per cent and of coffee 11 per cent. In the period 1889-92 the price of mandioca flour fell 11 per cent and of salt 8 per cent while general prices rose 36 per cent and exchange fell 52 per cent.

In the periods of rising exchange, 1843-47 and 1885-89, prices also rose (10.4 per cent and 5 per cent respectively), or the internal purchasing power of Brazilian currency fell while external purchasing power was rising. In the period 1868-75 while average prices (taking 9 articles) fell 13 per cent, the price of jerked beef rose 47.5 per cent (average of plate and Brazilian jerked beef), of bacon 20 per cent and of mandioca flour 4 per cent. Again, during 1885-89, while exchange rose 33 per cent, prices of the following articles also rose: mandioca flour 48 per cent,

(2). As regards exported articles, while some rose in price, others fell. On the whole the average rise in the prices of exported articles was much less (11 per cent in 1895) than the extent of the fall in exchange (41.5 per cent in 1895).

(3). On the whole the internal purchasing power of the rupee, taking imported and exported articles together, decreased very little in 1895 (4 per cent) as compared with the fall in exchange.

At a time when European prices are stationary, a rise in exchange from 15d. to 18d. gold should produce a heavy fall in Indian prices. But if Indian prices fall very little as compared with the rise in exchange, and at the same time there is a clear downward movement of European prices, one may very well doubt whether Indian prices have become adjusted to the 18d. rate.

The Currency Report says:—

“A further indication of equilibrium between internal and external prices during the last twelve months is to be found in the steadiness of exchange. Exchange is the mechanism by which differences between these two price levels (rupee prices and world gold prices) are adjusted, and by which they are, as it were, kept in gear. When exchange remains steady over a fairly long period it may ordinarily be inferred that there are no differences to be adjusted” (para. 189).

Our own experience from 1899 to 1914 shows that it is possible for exchange to remain steady even when prices in the country are rising more rapidly than world prices. From the steadiness of exchange during a period of twelve months it is wrong to infer that the adjustment of Indian to world prices is complete.

From 1899 to the outbreak of the world war exchange remained stable and did not fall below 1s. 4d. except in the crisis of 1907-08. The severe financial crisis in America and the con-

coffee 30 per cent, sugar 18 per cent, salt 20 per cent, jerked beef 16 per cent and rum 9 per cent.

These facts show that,

(1) External and internal purchasing power of currency do not always rise and fall together.

(2) When they are moving in the same direction the extent of the movement in the two cases is not the same.

(3) Prices of certain commodities of consumption and export may rise or fall when exchange is rising or falling—that is, internal purchasing power in terms of certain commodities may rise when exchange is falling, and *vice versa*...

sequent monetary stringency in the money markets of the world combined with the failure of the summer monsoon in India in 1907, caused Indian exchange to fall suddenly in November of that year. Government were asked to give gold for export, but they refused, with the result that on November 23rd exchange fell below specie point, *i.e.*, to 1s. 3 23/32d. Exchange improved when Government began to sell sterling bills on London.

According to the index numbers of the Statistical Department, prices of all exported articles in India, excepting raw sugar, silk, lac and indigo, were higher in 1913 than in 1899; excepting sugar and salt, prices of all imported articles had also risen. The index number for the 28 exported articles rose from 100 in 1899 to 154 in 1913, and that for the 11 imported articles rose from 87 in 1899 (1873=100) to 117 in 1913. The general index number based on the prices of 39 articles rose from 96 in 1899 to 143 in 1913 and 147 in 1914.

A special committee was appointed by the Government of India in 1910 to investigate the rise of prices between 1890 and 1912. The Committee collected a great mass of useful information bearing on the movements of prices in India and other countries before the war. The basic period selected for the inquiry was the quinquennium 1890-94. This was, on the whole, a normal period unaffected by famine. The investigations of the Committee showed that while prices throughout the world had risen, the rise of prices was greatest in India.*

The causes of stability of exchange are to be found in the conditions of trade which were favourable throughout the period, except in the crisis 1907-08, when for a time the balance of trade turned against India and exchange fell. There was a serious decline in net exports in 1908-09, in consequence of which net imports of gold in that year amounted to only 435 lakhs as against 1737 lakhs in the preceding year. In the quinquennium 1909-10 to 1913-14 net exports from India reached a total of 7256 lakhs, and net imports of gold a total of 2815 lakhs. It is these figures which explain the strength of Indian exchange.

*Report on the Enquiry into the Rise of Prices in India, Calcutta, 1914, Chapters IV and V.

It would have been surprising if the gold value of the rupee had fallen when trade conditions were so favourable for India. But it is remarkable that the exchange value of the rupee remained stable at a time when the rupee was depreciating rapidly in terms of commodities in India. There is no connection between the exchange movement and the price movement in the period 1899-1914.

In the course of his evidence before the Chamberlain Commission Sir Lionel Abrahams of the India Office referred to the very slight connection which exists between the volume of token coinage and stability of exchange.* In the long run, of course, appreciation or depreciation of the standard in terms of commodities must affect exchange, but there are many things which ought to happen in the long run but which don't.

The relation between exchange and prices is not a simple one. The external purchasing power of money in terms of foreign currencies may rise when the internal purchasing power in terms of commodities is steadily falling; the external purchasing power may remain stable when prices within the country are rising; the external purchasing power may decrease heavily while the internal purchasing power remains practically the same. And when the external and the internal purchasing power are rising or falling together, the extent of the rise or fall is not always the same in the two cases.

The history of money in Europe since the war provides many illustrations of this lack of precise adjustment between the price movement and the exchange movement. For example, during the war, the depreciation of the mark and the crown in terms of foreign currencies was less than the decrease in the internal purchasing power. Even in July 1920, while the price of Swiss francs had increased 29 times the pre-war price, the cost of living had increased 37 times in Hungary and 52 times in Austria. In October of the same year, however, the rise in the price of Swiss

*I think the connection between the volume of token coinage and the stability of exchange is very remote, as indeed is shown by the fact that now at this moment the token coinage is of greater volume than ever before and I think one might almost say that exchange is more stable than it ever has been. According to my view the stability of exchange depends on trade conditions, and the trade conditions may be affected, I admit, but are slowly and indirectly affected, if at all, by changes in the volume of currency."

francs in Hungary exceeded the rise in the cost of living, and similar was the situation in Austria in January 1921.*

In the period 1895-98 Indian exchange should have fallen but for certain financial measures adopted by the Government. Further, between 1899 and 1914 exchange remained stable, except in 1907-08, in spite of the more rapid rise of prices in India than in other countries. This would show that exchange may be kept stable by artificial means, whether prices are rising or falling. A good illustration is furnished by the Russian Tscherwonez in 1923. While its purchasing power in terms of the English £ and the American dollar remained fairly stable, its internal purchasing power in terms of goods fell. "This circumstance," says Markoff, "is extraordinarily interesting and important. It shows that so far as exchange is concerned, favourable circumstances exist, which exert no influence on the maintenance of the internal purchasing power."** Foreign trade is a state monopoly in Russia and exchange can be kept stable by increasing exports and restricting imports, or by means of a favourable balance of trade. But, at the same time, owing to causes affecting the supply of money, or of goods, prices may rise continually within the country. In the case of Russia the rise of prices in 1923 is attributed to inflation.

Even when foreign trade is not a state monopoly, favourable balances of trade and prompt action on the part of Government when exchange shows signs of weakening, backed by strong reserves of gold, may prevent exchange from falling, when, on account of the increase in the supply of token money (which is not convertible into gold for internal purposes) prices are rising rapidly. Such is the experience of India.

The internal and the external purchasing power must vary in the same manner if we ignore the special influences to which exchange is subject, such as movement of funds, speculative buying and selling of currencies and psychological factors which have no connection with prices. We must further assume that prices

**Das Geldproblem in Mitteleuropa* by Dr. Elemar Hantos, p. 54. (Jena, 1925, Gustav Fischer).

***Der Geldverkehr in Sowjetrußland* by A. P. Markoff, p. 7 (Verlagsdruckerei Beruard and Graefe, Berlin).

tend to be the same all over the world, and any inequality is immediately corrected by the export or import of gold. A country in which prices are higher than world prices will export less and import more, so that the balance of trade and exchange must turn against it. But are these assumptions correct? Is it not rather true that prices are *not* the same in different countries? "The purchasing power of *ig. gold*," says Gruntzel, "was always less in the United States than in England, and in England less than in Germany, and indeed permanently."* Further, the pre-war history of our own currency shows that a country may export more and more goods and import more and more gold even when its prices are rising more rapidly than world prices.** A check may come later, but in the meantime the country in question will suffer from all the evils of inflation in spite of its stable exchange.

**Geldwert und Wechselkurs* by Dr. Joseph Gruntzel, p. 29. (Wien, 1923).

**".....the goods of one country are not easily replaceable by the goods of another country, because one can buy coffee, cotton, rubber, copper and even many manufactured products only in those countries where they are produced, and must therefore often pay a higher price for them than would be justified according to the general price level which has hitherto prevailed. Gold has a world market; each good or service, however, first of all a national market; one speaks of a world market only in an approximate sense when a commodity acquires importance for several economic regions." *Ibid*, p. 29.

III

INDIA'S FOREIGN TRADE, 1920-21 TO 1925-26.

A rise in exchange, other things being equal, tends to restrict exports, and to encourage imports. The expansion of imports tends to lower the prices of imported goods, as also of goods manufactured within the country which compete with imported goods; the restriction of exports tends to lower the prices of articles of export. In a discussion of the adjustment of Indian prices to the 1s. 6d. rate, therefore, the reference to India's foreign trade is relevant. How far do the figures of India's exports and imports in recent years show signs of adjustment to the 1s. 6d. rate?

The following table shows India's balance of trade in merchandise (private) from 1920-21 to 1925-26:—

India's balance of sea-borne trade in merchandise (private) from 1920-21 to 1925-26. (+) indicates net exports and (—) net imports.

Lakhs of rupees.

	Exports of Indian merchandise.	Re-exports of foreign merchandise.	Imports of foreign merchandise.	Balance of trade in merchandise.
1920-21	240,01	18,04	335,60	— 77,55
1921-22	231,38	14,06	266,34	— 20,90
1922-23	299,16	15,16	224,31	+ 90,01
1923-24	348,84	13,07	217,03	+144,88
1924-25	384,66	13,51	243,16	+155,01
1925-26	374,86	10,49	224,11*	+161,24

It will be seen that the balance of trade turned heavily against us in 1920-21, and in 1921-22 also the imports of merchandise exceeded the exports of merchandise. The position began to improve in 1922-23, and since then net exports from India have steadily increased.

*Exclusive of the value of Railway materials imported direct by State Railways working under Company management, which was not paid for in the ordinary way and not therefore taken into account in arriving at the balance of trade.

The explanation of the fall in exchange in 1920-22 and of the rise in exchange since 1923 is found in these figures, and not in any movement of Indian prices in relation to prices in the United Kingdom or other countries. It should be noted that in spite of the rise in exchange, net exports from India have continued to increase. The position is abnormal, and points to a lack of adjustment between prices in India and the rate of exchange.

The high level of net exports of merchandise from India in recent years is due to the fact that while, on account of five successive good monsoons, and gradual increase in the buying power of Europe, exports from India have increased in volume as well as value, the volume of imports into India is still below the level of 1913-14.

The total value of imports into India (private merchandise) in 1913-14 was Rs. 183.24 lakhs, and in 1925-26, Rs. 226.08 lakhs, or an increase in value of 23.4 per cent in 1925-26 as compared with 1913-14. But the rise of prices is wholly responsible for this increase in the value of imports. The volume of imports (quantities of the principal classes of imported goods) has shrunk. This is shown by the following table:—

	1913-14	1925-26.		Decrease per cent. in quantity im- ported in 1925 as compared with 1913-14.
	Quantity 1000.	Quantity 1000.	Value Lakhs.	
Boots and shoes, pairs	3,295	1,353	40	59
Cement, cwt.	2,930	2,200	64	25
Tiles, No.	18,024	15,220	24	16
Candles, lbs.	2,264	483	2	79
Canes & Rattans, cwt.	63	38	5	40
Dyes obtained from coal tar, lbs.	16,245	10,323	1,43	36
Fruits and vegetables, dried, salted, etc., cwt.	1,041	65	1,39	94
Liquors, gals.	6,785	5,695	3,33	16
Matches, gross	13,894	7,928	93	43
Mats and matting, ex- cepting coir & rubber, sq. yds.	2,159	851	3	61
Metals, tons	1,078	945	25,35	12
Oil cloth & floor cloth, sq. yds.	1,646	818	9	50
Paints and painters' materials, cwt.	384	358	1,01	4
Paper making materials, cwt.	247	239	25	3
Pitch, tar and dammer, cwt.	285	158	10	45
Biscuits & cakes, lbs.	9,345	4,480	41	52
Ry. plant and rolling stock—				
Sleepers of steel or iron, cwt.	1,819	640	55	65
Sleepers of wood, cwt.	1,049	260	13	75
Other kinds, cwt.	539	280	34	48
Salt, tons	606	560	1,04	8
Sugar, cwt.	17,937	16,200	15,83	10
Textiles, Cotton—				
Handkerchiefs & shawls in piece, No.	38,088	6,200	22	84
Piece-goods—				
Grey (unbleached) yds.	1,534,189	709,085	21,88	54
White (bleached) „	793,345	465,112	15,99	41
Coloured, printed or dyed, yds.	831,769	366,835	15,92	56
Fents, yds.	37,824	23,678	70	37
Flax, canvas, yds.	3,699	1,251	16	66

	1913-14	1925-26		Decrease per cent. in quantity im- ported in 1925- 26 as compared with 1913-14.
	Quantity 1000.	Quantity 1000.	Value Lakhs.	
Flax, piece-goods, yds.	2,944	613	4	79
Silk, goods mixed with other materials, yds.	8,163	1,600	24	80
„ piece-goods, yds.	27,338	16,281	2,11	40
Wool, yarn and knitting wool, lbs.	1,058	1,037	36	2
„ carpets and rugs, lbs.	1,980	1,381	29	30
„ hosiery, lbs.	537	370	21	31
„ piece-goods, yds.	27,323	14,575	2,92	47
„ shawls, No.	2,100	570	28	73
„ other sorts, lbs.	1,526	186	3	88
Umbrellas, No.	1,967	830	9	83
Total Value	—	—	115,00	—
Grand total value of imports of private merchandise.	—	—	226,08	—

The value of imports of the articles mentioned in the table in 1925-26 was Rs. 115,00 lakhs as compared with Rs. 226,08 lakhs, the total value of imports of private merchandise in that year. The imported articles whose quantity decreased in 1925-26 as compared with the pre-war year 1913-14 thus represent about 51 per cent of the total imports.

Attention may be particularly drawn to the heavy decrease in the quantity of cotton goods imported into India. In 1913-14 the imports of cotton piece-goods amounted to 3,497,127,000 yards; in 1925-26 the imports had fallen to less than half—1,563,710,000 yards.

The total value of the exports of Indian merchandise to foreign countries increased from Rs. 224,20 lakhs in 1913-14 to Rs. 374,86 lakhs in 1925-26, or an increase of 53.5 per cent in 1925-26 as compared with 1913-14. The increase in value is not wholly due to the rise of prices. In the case of several important articles of export, there has taken place an increase in the quantity exported. This is shown by the following table:—

Table showing the quantity and value of the exports of certain articles from India.

	1913-14.		1924-25.		1925-26.	
	Quantity 1000.	Value Lakhs.	Quantity 1000.	Value Lakhs.	Quantity 1000.	Value Lakhs.
Dyeing and tanning substances, cwt. ---	1,467	104	1,512	1,35	---	---
Fibre for brushes and brooms, cwt. ---	80	13	100	2.1	100	23
Fish, cwt. ---	252	39	---	---	272	76
Grain, pulse and flour, cwt. ---	83,394	45, 4	85,100	65,06	---	---
Hides and skins, tanned or dressed, cwt. ---	304	4,22	380	7,18	360	6,97
Lae, cwt. ---	339	1,96	427	7,55	539	6,90
Metals and ores, tons ---	822	2,19	1,121	7,18	11,22	7,28
Oilcakes, cwt. ---	3,506	1,38	3,850	2,19	3,820	2,10
Tea, lbs. ---	289,473	14,97	340,106	33,39	325,753	27,12
Cotton, raw, cwt. ---	10,626	41,64	11,850	91,22	14,900	94,99
" piece-goods, yds. ---	89,233	9,81	181,511	6,85	164,833	6,15
Hemp, raw, cwt. ---	297	1,02	668	1,72	623	1,59
Jute, gunny bags, No. ---	368,719	12,53	425,141	23,21	425,083	26,72
" gunny cloth, yds. ---	1,061,151	15,59	1,456,288	23,27	1,461,380	31,80
Silk, raw, lbs. ---	1,203	24	1,616	38	1,466	35
Wool, raw, lbs. ---	48,922	2,50	52,798	5,07	---	---
" carpets and rugs, lbs. ---	1,640	23	5,710	1,12	3,875	77
Tobacco, lb. ---	30,023	47	44,140	1,55	38,048	1,11
Total value, lakhs ---	---	---	---	283,25	---	214,83
Grand total value of exports of Indian merchandise, lakhs ---	---	---	---	384,60	---	374,46

The value of the articles mentioned in the table represents 57.3 per cent of the total exports of private merchandise from India in 1925-26.

An analysis of the figures of our sea-borne trade in 1924-25 gives similar results. The value of the imports whose quantity decreased in 1924-25 as compared with 1913-14 represents a little more than 57 per cent of the total imports in 1924-25; the value of the exports whose quantity increased in 1924-25 as compared with 1913-14 represents about 74 per cent of the total exports in 1924-25.

These figures suggest that in the coming years the expansion of the import trade may be expected to be relatively greater than that of exports from India. Allowance, of course, has to be made for the effect of the enhanced rate of the general tariff now in force, for the effect of protection in limiting the imports of certain articles, and for increase in home production which would render us less dependent upon foreign countries for the supply of manufactured goods. On the other hand we have to allow for the gradual expansion of demand in India and for increased world production. It should also be borne in mind that in the long run it is impossible for exports to increase while imports are shrinking. The decline in imports is bound to react on exports. On the whole, taking into consideration the present low level of imports, it appears more than probable that during the course of the next five or ten years imports will increase.

GENERAL CONCLUSION.

The fact that Indian prices have not yet become adjusted to the 1s. 6d. rate, and that imports into India are still abnormally low while exports have increased in volume as well as value, suggests that time is not yet ripe for the stabilization of exchange. It would be best to wait and see what rate of exchange is produced by trade conditions in the next two or three years. The 1s. 6d. rate is the result of good monsoons for a number of years and the low level of imports. It is possible, and I think probable, that when imports increase, the rate of exchange will fall.

No sensible man in India would insist that the Government

should immediately proceed to inflate the currency with the ultimate object of raising prices in the country above the level of world prices, so as to reduce the exchange value of the rupee to 1s. 4d. But it is the greatest mistake to think that because 1s. 6d. is the prevailing rate, under somewhat abnormal conditions of foreign trade, little difficulty will be experienced in maintaining exchange at that rate in the future. Let us gain some more experience of the 1s. 6d. exchange before permanently fixing the exchange value of the rupee at this rate.

What I have said in the preceding Chapters must not be interpreted as an argument in favour of the immediate stabilization of exchange at 1s. 4d.; *but it is a strong argument in favour of waiting.*

There is need for caution particularly because the 1s. 6d. rate does not promote the interests of Indian manufacturing industries, nor of the Indian export trade, whatever may be its advantages from the point of view of Imperial finance.

By the same Author :
THE POPULATION OF INDIA
(A Comparative Study)

1925, pp. 215 with Index. Cloth bound, Rs. 4.

PREFACE.

The object of this book is to examine the influences which have a bearing on the growth of population in India.

The death rate and the rate of infant mortality in India are the highest in the world. India has the largest number per 1,000 of children below ten and the smallest number of persons above fifty. The average duration of life in India is less than in any European country, and what is more remarkable still is the fact that while the expectation of life, or the mean after-life time at certain ages, has increased in European countries, it is decreasing in India. There is no country in the world whose population is controlled by disease to the same extent as the population of India, and in spite of the universality of marriage and the high birth rate, the population of India increases more slowly than that of the leading countries of the world (with the sole exception of France).

What is the explanation of this extraordinary state of things? The high death rate and the shorter duration of life are in part due to the climate of the country, the people's ignorance of the laws of health, the general insanitary condition of towns as well as villages and the evil custom of early marriage, but there is still, as has been said, "an extravagant reaction to conditions of public health" in India. What are the causes of this reaction? Malthus regarded disease as the necessary consequence of over-population. Is India over-populated?

Over-population does not mean the tendency of the population to out-grow the means of subsistence—the sense in which Malthus used the term. The view has been taken in this book

that, at the present time, the quantity of human food which a country produces or can acquire is a factor of very little importance in determining the growth of population. The rapid increase of numbers in the leading countries of the world since 1850 and the circumstances which made it possible show that the growth of population, in general, ultimately depends on economic conditions, of which the supply of food is one. The solution of the population problem in India thus depends on the solution of the problem of poverty.

Over-population results when population increases more rapidly than national income and wealth. Unfortunately, on account of the lack of reliable statistical material, it is difficult to calculate exactly the national income of India, or the changes in its amount, during the past thirty or forty years. But the major portion of India's national income is agricultural, and agricultural income increases slowly. Agriculture to-day, however, is supporting a higher percentage of the people than ever before, and there is very little doubt that *per capita* real income of ordinary cultivators has not increased—it has probably decreased.

India is not over-populated in the absolute sense, that is, we have not reached that stage where, on account of the exhaustion of the soil, or of the possibilities of industrial development, the national income has ceased to grow, and therefore the population must cease to expand. The rate of growth in the future, however, must be chiefly determined by the degree of success attained in developing agricultural as well as non-agricultural sources of income, and thus augmenting national income *per capita*.

The book contains numerous references to European conditions. The Indian reader, it is hoped, will find the information given about other countries useful for a comparative study of our population problem. For this information I have been forced to rely on second-hand sources, but these sources are excellent—*Handwoerterbuch der Staatswissenschaften*, Conrad's *Statistik* and Georg von Mayr's *Bevoelkerungsstatistik*.

Lahore, Maclagan Road.

Brij Narain

January 16, 1925.

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PRESS OPINIONS.

INDIAN.

"The author covers the whole range to be traversed in dealing with the subject and he brings to the discussion critical acumen and knowledge. The book is fairly exhaustive in its scope, and accurate in its data and conclusions." *The Hindustan Review*, October, 1925.

"...an excellent and informing treatise..." *The Bengalee*, March 15, 1925.

"...a genuine model for research students in the field of economics..." *Forward*, March 22, 1925.

"The author who is already well known as a keen student of Indian Economic Problems, has undoubtedly made another valuable contribution to India's economic literature and we recommend it to the public and social reformers as well as to our universities and administrators." *United India and Indian States*, December 5, 1925.

FOREIGN.

"...in the main, the work is sound, and good service has been done in calling attention to tendencies of increasing moment to the welfare of India." *Journal of the Royal Statistical Society*, March 1925.

"In dem vorliegenden Buche haben wir es mit einer auusserst interessanten Leistung zu tun, die nicht nur fuer die Kenntnis der wirtschaftlichen und sozialen Zustaeude in Indien, sondern auch als Beitrag zum Bevoelkerungsproblem, das fuer den Verfasser bei seinen Darlegungen immer im Vordergrunde steht, sehr beachtenswert ist." *Weltwirtschaftliches Archiv*, Kiel Bd. XXII, 1925 II.

TRANSLATION.

"In the present book we are concerned with an extremely interesting performance, which is a noteworthy contribution not only to our knowledge of the economic and social condition of India but to the population problem, which always occupies the central place in the author's treatment."

"Aber auch jedem, der nur an Indien interesse nimmt, wird das Buch einfach unentbehrlich sein. Unseres Wissens findet sich das Material des Buches bislang ueberhaupt noch nirgends in dieser verarbeiteten Form." *Wirtschaftsdienst (Hamburg) of April 9, 1926.*

TRANSLATION.

"The book is simply indispensable to every one who is interested in India. So far as we are aware, the material given in the book has nowhere been worked up in this form."

"Das ganze Buch ist anregend und fliessend geschrieben, und fesselt besonders durch die Grosszuegigkeit, mit der die Bevoelkerungsfrage in den Zusammenhang der anderen grossen Wirtschaftsprobleme gestellt ist." *Zeitschrift des Statist. Landesamts, Germany.*

TRANSLATION.

"The whole book has been written in a fluent and suggestive style, and it attracts particularly on account of the comprehensive manner in which the question of population has been dealt with in connection with other important economic problems."

"Gestuetzt auf eine ausgezeichnete gleichmaessige Kenntnis der europaeischen, insbesondere der deutschen, wie der indischen Statistik und ihrer Literatur, sucht Verf. in aeusserst anregenden und leicht verstaendlichen Ausfuehrungen diese Frage zu beantworten....Die Lektuere des gazen Buchs kann aufs waermste empfohlen werden." *Archiv fuer Politik und Geschichte, December 1925.*

TRANSLATION.

"Supported by an excellent knowledge of European, particularly German, as well as Indian statistics and literature, the author attempts to answer these questions in an extremely suggestive and easily understandable manner. The study of the whole book is most warmly recommended."

"Frei von aller polemischen Schaerfe gagen englische Wirtschaftspolitik und mit grosser, auch an deutscher Wissenschaft geschulter theoretischer Klarheit wird darin die vieleruerterte Uebervoelkerung Indiens als lediglich verhaeltnismaessig zum heutigen Entwicklungsstand seiner Produktivkraefte erwiesen...." *Vierteljahrschrift fuer Sozial-und Wirtschaftsgeschichte, 19 Band, 1-3 Heft.*

TRANSLATION.

"Free from all polemics against English economic policy, and with great theoretical clearness, result of the study of German science also, the much discussed over-population of India is shown to be in relation to the present stage of development of India's productive powers....."

"Das Buch verarbeitet ein umfangreiches statistisches Material mit Umsicht und Kritik; die gruendliche und klare Darstellung verleiht dem Werke den Charakter eines wertvollen Handbuchs, zu dem auch der Nichtfachmann mit Nutzen greifen wird, um sich schnell und zuverlaessig zu orientieren." *Zeitschrift fuer die gesamte Staatswissenschaft*, 81, 1.

TRANSLATION.

"The book works up large statistical material carefully and critically; thorough and clear treatment lend the work the character of a valuable handbook, which will be useful also to the layman for getting reliable information quickly."

**SOME ASPECTS
OF
THE INDIAN CURRENCY PROBLEM.**

BY

H. L. CHABLANI.
ECONOMICS DEPARTMENT, DELHI UNIVERSITY.

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PREFACE.

This brochure contains very little that can be called new matter. Most of it is only a reprint of what has already appeared in the press. The only excuse for publishing it is the demand for copies of some of my recent contributions to which Sir Basil Blackett made a generous reference in his address before the Delhi University on the 23rd of November 1926. It is not likely to please either the critics of the Gold Bullion Standard or the advocates of *immediate* stabilisation at 1s. 6d or 1s. 4d ; but if it serves to dispel some of the popular errors on the subject and induce our legislators and our students of economics to take a balanced and dispassionate view of the recommendations of the Royal Commission on Currency, it will have served its purpose.

DELHI UNIVERSITY: }
10th February 1927. }

H. L. CHABLANI.

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I.

THE INDIAN CURRENCY PROBLEM.*

It is unfortunate that the Royal Commission on Currency decided to hold its sittings *in camera*. Indian opinion has all along been extremely suspicious of Government's currency policy ; and rightly or wrongly the impression is widespread that the Government wishes to continue the policy of manipulating the currency for its own ends. The personnel of the Commission had been freely criticised as extremely unsatisfactory from the Indian point of view. Under these circumstances the Commission would have been well advised to conduct its proceedings in the open so as to enable the public to appreciate at their true value the different proposals that have been put forward by witnesses. The world has moved a long way off the notions of sound currency which people entertained a generation back ; and the cross-examination of witnesses who are unable to keep abreast of the times would have been an education in itself. The Indian Currency system as it exists to-day is not easy to understand ; throughout the period of its evolution it has been the target of bitter attack and criticism. Though hopelessly ignorant in currency matters, the man in the street is positively certain that something is radically wrong with a system that makes it impossible for the wage-earner to maintain a customary standard of comfort, for the agriculturist to secure a reasonably certain value for his cotton, and for the manufacturer to get a fairly certain return for his investment and enterprise. Rightly or wrongly, he feels that Government is at the bottom of this sinister business and that all these Commissions are intended only to throw dust in the eyes of the public. The result is most deplorable not only from the standpoint of scientific truth but also from that of the Government itself. However sound in principle the final recommendations of the Commissions may turn out to be, they are foredoomed to condemnation unless they happen to coincide with the opinion of vociferous Bombay. The *purdah* proceedings have deprived the Commissioners of an invaluable opportunity of educating the public in currency matters. The most scientific system of currency is bound to fail in an atmosphere of distrust and suspicion ; for public trust and confidence are the very essence of the matter in all currency reform.

This appeared as an article in 'The People' on the 17th of January 1926.

UNANIMOUS DEMAND FOR AN AUTOMATIC GOLD STANDARD.

Most of the Indian witnesses are agreed on one point ; they all want an automatic gold standard that will not only give India a greater stability of prices but also reduce automatically the fluctuations of these "confounded exchanges" to the limits of gold import and gold export points. They all want our monetary standard to be free from the possibility of manipulations by Government or a State Bank, to be both "knave proof" and "fool proof." Differences of opinion centre round the relatively subsidiary questions of (a) the most desirable form of gold standard, (b) the future position of the rupee in our monetary system, (c) the ratio between the rupee and gold, and (d) the proper time for a complete solution of the currency problem.

A GOLD CURRENCY NOT ESSENTIAL.

The gold standard is associated in the popular mind with a *gold currency in actual circulation*. It is unfortunate that most of our independent witnesses have a lingering fondness for this old fallacy and have gone to the length of arguing with considerable warmth that a gold currency will be a most suitable *medium of exchange* in India. It is interesting to note that this is in direct opposition to the line taken by our older publicists before the Herschell and Fowler Commissions. In 1898, Sir D. E. Wacha in voicing Indian opinion from the platform of the National Congress said : "For consider as you may, you cannot help admitting the fact that bearing in mind the poverty of the people and their *immemorial habits and usages*, gold can never become the currency. Silver alone is suitable and convenient. It is the natural currency." And several witnesses before the Fowler Commission pointed out that "for the man in the street and the man in the village or the village-shop, a gold coinage would be absolutely useless." Even the members of the Fowler Committee, who expected gold to circulate when both the rupee and the sovereign were unlimited legal tender and coined on demand in unlimited quantities, had no illusions on this point ; they frankly admitted that "there was little or no likelihood, even according to the most sanguine view, that for a long time to come gold coins, even if declared a legal tender forthwith, would find their way to any great extent into general circulation." It was only before the Chamberlain Commission that a few witnesses attempted to make out a case for a gold currency in *actual circulation* and based it almost entirely on the figures relating to the absorption of gold sovereigns by the public. A clever theorist like Mr. J. M. Keynes had no difficulty in pointing out that if a gold currency in

actual circulation was the essence of a gold standard, no country in the world had it except Egypt and proving that the figures relied on went only to show "the existence in India of an enormous demand for *gold bullion*, a very considerable demand for sovereigns for the purposes of *hoarding* and only a relatively smaller demand chiefly confined to the United Provinces, the Punjab, Madras and, Bombay, for purposes of *currency*." The advocates of a gold standard in India thus broke down chiefly because *they identified gold standard with a gold currency in actual circulation.*

POSSIBLE ALTERNATIVES.

Most of the Indian witnesses examined so far have, I fear, lost a strong case for a gold standard by committing the same mistake this time too. A few associations, like the Marwari Indian Association of Calcutta have, however, realised the weakness of this position only to fall into a still greater error. Like the Fowler Committee they wish both the rupee and the mohur to be unlimited legal tender and minted on demand in unlimited quantities. This is to forget the operations of Gresham's law, for under such conditions gold cannot possibly remain in circulation; the inferior coin will drive the superior out of circulation.

If you wish to retain some gold in actual circulation, you must either stop the coinage of rupees, retaining them as unlimited legal tender or make the rupee only a *limited* legal tender, freely convertible into gold. If the rupee is really the most suitable medium of exchange in India, the first will only be a *temporary* solution.* For a time, the existing volume of rupees will no doubt suffice; but if the bulk of transactions in India continue to be small, it will be necessary to remint rupees unless the immemorial currency habits of the people change in the meanwhile. At first sight the second alternative may appear inconsistent with the maintenance of the rupee as the principal medium of exchange in India. But in reality, it is not so. If the *bulk* of transactions in India involve only *small* amounts, the rupee will continue to be the principal medium of exchange among the masses in their every day life in spite of its being only a limited legal tender. It is only among the richer classes, and those chiefly in towns that gold will circulate as coin. The rupee will have practically the same position as cheques occupy in England and notes in continental Europe. It is necessary,

* It will not work even as a temporary solution in a period of falling world prices as there will be no automatic process of contracting currency and so maintaining a fixed rate between the rupee and the gold coin.

however, that it should be freely convertible into gold, just as cheques or notes were in advanced European countries in pre-war days. Only a minute fraction of the population in Europe had any occasion actually to handle a gold coin even in pre-war days; and yet nobody suggested that on that account cheques and notes should be declared inconvertible into gold.

OBJECTIONS TO A GOLD CURRENCY.

The only serious objections to this form of gold standard are (1) its expense; and (2) its effect on the world price of gold. The question of expense must not be brushed aside so lightly as some of the Bombay publicists have actually tried to do.* There is no adequate reason whatsoever why a poor nation like India should allow even a part of its very limited resources to be locked up in gold currency if a cheaper substitute can serve the purpose of a sound currency as well as gold; and the burden of proof lies heavily on those who argue that a cheaper substitute is not possible or feasible. Be that as it may, it is the second objection that is really the weightier of the two; it therefore demands the most careful consideration. Several Bombay witnesses have referred to the restoration of gold standard in other countries as if it supported their case for a gold currency in actual circulation. They seem hardly to realize that it weakens their case considerably. The restoration of the gold standard in England does not mean the restoration of gold to circulation; it does not even mean the conversion of sterling freely into *gold coin*; it only means the convertibility of sterling into gold bars of not less than 400 oz. In none of the European countries has the slightest suggestion been made that gold *coins* should be introduced into *actual circulation*. Everywhere, special efforts are being made to prevent this possibility, for it is everywhere recognised that it will be an extremely undesirable consequence of the restoration of gold standard in the world. If gold is allowed to circulate as currency even in a few of the principal countries of the world, the demand for it will be so heavy as to raise considerably the price of gold and bring about a heavy fall of prices in gold standard countries. Even without this additional demand for *gold in actual circulation*, experts like Prof. Cassel and Sir John Fergusson expect a downward trend in prices. The monetary reconstruction in the world must inevitably lead to a greater demand for gold as currency reserve; the world's production of gold, in the absence of *large* fresh discoveries, is likely to decline substantially over

* In this connection see memorandum No 3 submitted by Mr. C. H. Kisch C. B. Volume III Appendices to the Report of the Currency Commission and the evidence of Prof. Gustav Cassel pp599 Appendix 92 vol III.

the next decade, owing mainly to the probability of gradual exhaustion of the Rand; and the introduction of mechanical aids to production and the cheapening of Industrial processes must expand the volume of wealth and so tend to make for an appreciation in the value of gold. The average annual addition to the world's stock of gold during the sixty years 1850—1910 was only 2·8 % the average yearly loss has been estimated at 0·2 % If economic progress continues at the pre-war rate, we need an increase in gold supplies at the rate of 3 %; in other words, taking 1923 as the basis for calculation, we must have about £109 millions of new gold yearly. The world's production of gold in 1923 or even 1924 was much below this figure—not more than two-thirds of this normal.* For the future, we must therefore reckon with a growing scarcity of gold compared with our growing needs, and the consequent fall of prices in countries under a gold standard.

Is it to the interest of any country except perhaps the U. S. A to accentuate or precipitate this inevitable fall of gold prices. Is it to the interest of a debtor country like India to enhance the purchasing power of gold over commodities? Do we want conflicts between labour and capital, a deepening gloom over both trade and industry such as a heavy fall of prices will inevitably produce? The danger of which I am speaking is not a mere theoretical possibility. Ample warnings exist in history of the consequences of an ill-regulated competition for precious metals. The breakdown of the return to special payments in England, Austria and Russia in the period 1816-18, the chronic state of depression which prevailed during the spread of the gold standard in the period 1876-96, are two well-known instances on this point. Even the present situation in England shows which way the wind is blowing. Since October 1924 sterling prices have shown a marked downward trend; and in all probability the fall would have been more pronounced but for the budgetary deficit of £36 millions for the first half of the financial year 1925-6 and the embargo on foreign loans, removed only in December 1925. It is generally unsafe to prophesy in matters of price movements; the factors to be taken into account are so many and so uncertain. But one feels almost certain that if the Indian Government is compelled by pressure of agitation to concede what India seems to demand, viz., a gold currency in actual circulation, and other countries follow the bad example and restore gold to circulation, there will be a

*See in this connection the evidence of Governor Strong, Professor Gustav Cassel, and Mr. Joseph Kitchin Vol III Appendices to the Report.

marked fall of prices with all its attendant evils. One wonders if Bombay merchants realise fully whether the pet proposal of their economists is taking them. It may be a virtue to be self-conscious and assert that we shall have what we consider best for us irrespective of its consequences for others; but it is hardly a virtue to cut off our own nose in order to spite another. This is exactly what our demand for a gold currency in actual circulation amounts to. England will undoubtedly suffer if there is a heavy fall of prices because of our demand for a gold currency; England will be right in opposing this demand. But shall we gain if we assert our right to have what will injure *all*? It is enlightened selfishness and not philanthropy or political subserviency to endorse the *principle* of the Genoa Conference resolution in favour of "some means of *economising the use of gold.*"

AN AUTOMATIC GOLD STANDARD WITHOUT A GOLD CURRENCY.

Is it feasible to have an *automatic* gold standard without a gold currency in *actual circulation*? Is it possible to retain the rupee as the principal medium of exchange and yet make our currency system both "knife proof" and "fool proof?" I believe it is, if only we modify slightly the existing system. Let the rupees be made freely convertible into gold bars at a fixed rate internally; let the Paper Currency and Gold Standard Reserves be amalgamated and an adequate gold reserve located in India for ensuring this convertibility; and let the British sovereign cease to be legal tender. This will ensure the automatic expansion and contraction of our currency and link it with gold—a universally acceptable commodity. Ricardo's Exchange Remedy suggested the idea of Gold Exchange Standard, but unfortunately the existing system does not embody the essentials of Ricardo's scheme. The changes I suggest mean only a slight modification of Ricardo's remedy—the partial substitution of rupees for paper money. Complete convertibility is the basis of both the proposals; and both seek to prevent gold coin from entering into circulation by issuing gold in the form of bullion bars and not gold coins. The main defect of our pre-war currency system lay in the fact that it was not automatic in *contracting* currency. Legally, the rupees were never freely convertible into gold inside the country; nor were they externally convertible except on those rare occasions when Government sold Reverse Councils at times of weakening exchange. Our currency, therefore, failed to satisfy the most essential requisite of a sound currency, *viz.* stability of prices or purchasing power. But convertibility wi

be the best safety valve for redundancy of rupees; it will provide the easiest automatic danger signal to Government when it is inflating the currency. When the purchasing power of the rupee tends to fall relatively to its fixed gold equivalent, rupees will be exchanged for gold and withdrawn from circulation. Such a system of convertibility will not need for its success a large stock of gold if the British sovereign ceases to be *legal tender*. For, if the rupees in circulation are diminished and not replaced by gold coins, the value of the rupee will rise quickly to the point where it will cease to be profitable to exchange rupees for gold.

THE RATIO.

What should be the ratio between the rupee and the gold content of the British sovereign? That is comparatively a minor issue; for the adverse consequences, whatever they be, of either of the two suggested rates, 1s. 4d or 1s. 6d, will exist only during the period of *transition*.

II.

THE REPORT OF THE INDIAN CURRENCY
COMMISSION.*

The Report of the Royal Commission on Currency is undoubtedly an honest attempt at seeking a solution of one of our most complicated problems. Unfortunately, the mud which the Bombay publicists have been throwing at the Commission from the very beginning has created an atmosphere, very unfavourable to a dispassionate examination of the issues involved in the findings of the Commission. Prejudices die hard; and few among even the trained economists of India are prepared to revise their settled convictions of several years in the light of the recent advance in Currency theory and practice. Writing in December last in the columns of *'The People'*, I warned the Commissioners of the undesirable consequences of their *purdah* proceedings. The world has moved a long way off the notions of sound Currency which people entertained a generation back; and the public cross-examination of witnesses who were unable to keep abreast of the times would have given the Commissioners an invaluable opportunity of educating the public in Currency matters. The result of the proceedings *in camera* has come out to be exactly what I anticipated; and my fears that—"However sound in principle the final recommendation of the Commission may turn out to be, they are fore-doomed to condemnation unless they happen to coincide with the opinion of the vociferous Bombay"—have proved to be a correct prophecy.

A NEARLY UNANIMOUS REPORT.

A careful examination of the Report will show that the findings of the Commission are unanimous on all counts excepting one; and yet the Report is being bitterly commented on as a fresh proof of the inevitable antagonism between the Indian and the European points of view. Too much is being made of the *one* main difference between the Report and the dissenting minute, while very little notice is being taken of the many essential points of agreement between the two. After all, the question of *rate* does not constitute the *whole* of our Currency problem. Looked at from the *long period* point of view, it is a minor and not a major issue. The

* This is substantially the same as the article in *"The People"* of the 22nd August, 1926.

soundness or otherwise of the Indian Currency system does not depend in any way on the rate. The Report must be judged by its conclusions on the soundness of the existing Currency system and the nature of the remedy it suggests. On these fundamental issues, the Report is unanimous.

The Commissioners *unanimously* condemn the existing Currency system, and give their verdict in favour of the Indian view on all counts. They admit that "the automatic working of the exchange standard is . . . not adequately provided for in India, and never has been"; and that "under the Indian system contraction is not, and never has been, automatic" (para. 16). In other words, they endorse the Indian view that our Currency system is responsible for high prices. They point out that "there is no provision as to any organic relation between the total volume of token currency and the amount of the reserves"; and that the principles on which the efficiency of our reserves depends "are not now, and never have been, adequately supported and enforced by statutory provisions (para. 15). They consider it wrong in principle to divorce control of credit from control of currency and regard it as anomalous that the Indian Government continues to exercise direct control over currency in general and over the note-issue in particular. (para. 20). They view with concern the "inelasticity of our Currency system", especially its inability to provide additional cash for the support of credit in case of great financial crises (paras 18 and 19). They recognise that while "a substantial measure of stability has been attained in the past", "certainty and simplicity have been lacking"; and that "for a system of currency under Indian conditions and for the Indian people, these two qualities are as vitally necessary as the first" (para 22). And they conclude with the important admission that "when allowance has been made for all misunderstandings and misapprehensions, the fact remains that a large measure of distrust in the present system is justified by its imperfections" (para. 22). I wonder if a Commission packed with Bombay favourities could have gone further in condemning the existing system, or paid less regard to the prestige of the Indian Government. Surely, the Commissioners would not have put their signature to these paragraphs had they been a body of *johukums* as the Bombay press often describes them to be.

AGREEMENT ON FUNDAMENTALS.

As to the remedy for these inherent defects, the Commissioners

(not excepting Sir Purshottamdas) are agreed on fundamentals. All agree in rejecting as impracticable at present the *only* scheme for the *immediate* introduction of a gold standard with gold currency — the scheme put forward by the officials of the Finance Department, though Sir Purshottamdas disagrees “with some of the reasons adduced (by the majority) in support of that conclusion” (paras. 56 and 60 of the Dissenting Note). The majority recommend instead “the gold bullion standard,” which I suggested first in my *Indian Currency and Exchange* and further elaborated in my evidence before the Commission. The Dissenting member is fully “in agreement with the gold bullion standard as recommended by (his) colleagues” but presses for an unequivocal guarantee that there shall be “no interference with the free inflow of gold into India, except with due publicity and the concurrence of the Legislature” (para. 52 of the Dissenting Minute).

The majority regard the demonetisation of the sovereign and the half-sovereign as a necessary part of their scheme on the ground that “otherwise the gold from the reserve might in certain circumstances pass into circulation without effecting any contraction in the currency and thus without fulfilling the essential purpose of securing the compensatory effect of the exchanges” (para 65); Sir Purshottamdas does not “appreciate the necessity of this recommendation”; but is “prepared to view with diffidence (his) inability to see eye to eye with (his) colleagues” and does “not press his objection beyond recording his own opinion” (para 53). He, however, takes good care to state expressly that he shares “the hope that when the gold reserves of India are adequate, the people of India may not want a gold mint.” This makes it plain that the views of the two parties are the same both on the question of the ideal form of currency and on the narrower issue of what is *immediately* practicable under existing conditions.

THE CASE AGAINST A GOLD CURRENCY.

In the face of this practical unanimity of the Commissioners, let the Bombay experts put forward a more feasible scheme than Sir Basil Blackett's instead of wasting time in misleading the lay public by dangling before them the prospect of jingling gold or raising a ghost of sinister influences standing in the way of India's adoption of a gold currency. Let them argue if they will that our gold reserves can safely be reduced to 30 per cent during the transitional period; that absolute reliance can be placed on the anticipation that the initial demand for gold can be limited to 50 crores and the demand

spread over the period of 10 years ; that the sale of an amount of redundant silver equal to about thrice the world's production of a year combined with the factors pointing to a distinct diminution in the world's demand for silver in future will never produce a fall in the value of silver below 24d.; that the required credits can be raised abroad in case of need; that India can afford to do what richer nations like England are unwilling to do, *viz.*, put gold in active circulation; and that there is no force whatsoever in Sir Purshottamdas' view that "it is neither feasible nor desirable that sterling securities should be realised and converted into gold forthwith, or in any manner other than the safest and most gradual to the markets of the world" (para 50 of his Minute), or in his reply to impatient enthusiasts, pointing out "the advisability of India doing nothing to retard the reconstruction of devastated Europe, if it can be avoided by a slower and more natural process of accumulating gold for her requirements" (para. 50 of his Dissenting Minute). The Commissioners have shown clearly what alternatives are *immediately* possible under the present conditions. The choice, they point out, is between a gold standard without a gold currency, and an exchange standard with an excrescent and unnecessary gold currency which will only serve to disguise from the people of India the true basis of the stability of their currency. As between the two, no thinking man will deny that every advantage lies on the side of the Gold Bullion Standard that the Commissioners recommend. The Commissioners have likewise made it plain that their scheme is equally appropriate whether or not it be held that the Gold Standard should ultimately be supplemented by gold currency; for it provides for "a gradual but substantial strengthening of gold reserves, at the *maximum* rate, and to the *maximum* extent, possible under present conditions without upsetting prices, incurring excessive expenses or injuring trade by unduly restricting credit." They rightly observed that "if one desired that a gold currency should be introduced, it is thus that one would have to proceed." And they conclude by saying: "Our own view is that it would be unwise to contemplate the introduction of a gold currency under any conditions which we can foresee. But while holding that view, we have tried to see the matter from the point of view of those who do want a gold currency as soon as it can be had. It then appears to us that the following proposals open the door for the introduction of a gold currency at some future time as wide as is now possible to open it. They initiate a system which will leave the people of India perfectly free to decide, *through their legislature*, when that future time has come and a gold currency can be introduced without risk,

whether or not they are prepared to confront its expense, and to disregard its other disadvantages. It is quite possible that when that time comes, the people of India will no longer wish for a gold currency". Only fanatics can quarrel with this admirable spirit of compromise or scent in it a desire to promote the interests of other countries at the expense of India.

SOME MISCONCEPTIONS.

The Commissioners' reference to the effect on other countries of India's adoption of a gold standard with gold currency has given rise to a widely prevalent misconception that they have decided against a gold currency not because it was not good for India but because it was not in the interests of other countries. A careful perusal of the report knocks the bottom out of this gross misrepresentation. It is "*in their reaction on India as one unit in the world's trade system*" that a fall in gold prices and a curtailment of credit consequent on the increased competition for gold among the countries of the world, is considered, on balance, to be unfavourable (para. 37): it is because "*India, apart from her direct trade with China, which is a growing market for cotton and cotton goods cannot escape injury from a widespread dislocation*" of the world's trade with China that the Commission refers to the possible effects on China, (*vide* para. 50); and it is only because "*higher interest rates, business disturbance and economic depression*" in European countries will have "*inevitable repercussions on the economic well-being and commercial prosperity of India*" that the Commission recommends a limitation on the demand for gold (para. 53). The same reasons have led Sir Purshottamdas, who can hardly be accused of forgetting India's interests, to lay emphasis on "*the advisability of India doing nothing to retard the reconstruction of devastated Europe, if it can be avoided by a slower and more natural process of accumulating gold for her requirements*" (*vide* para 59 of his Minute). Both the majority and the dissenting member accept the view of Prof. Cassel and Mr. Kitchin that the future trend of world prices will be downward. Nobody can deny that this tendency will be accentuated if India introduces gold currency. One wonders if the *Bombay merchants who object to 1s. 6d ratio on the ground that it will produce a fall of prices and depress trade and industry, realise fully whither the pet proposals of their economists is taking them. Do they want conflicts between labour and capital, a deepening gloom over both trade and industry, such as a heavy fall of world prices will inevitably produce.?* Were it not so tragic, one would really feel amused at seeing the same

men crying themselves hoarse over the 1s. 6d rate because of its depressing effect on prices and shouting in the same breath for a gold currency which will depress prices still more. It is high time for Bombay to see this inconsistency and recognise that it is enlightened selfishness and not sycophancy or political subservience to endorse the principle of the Genoa Conference resolution in favour of "some means of economising the use of gold".

The Transitory provisions recommended by the Commission in para. 166 have caused another widely prevalent misconception. During the transition period the currency authority has been given option to buy and sell *gold or gold exchange*. This has led many to believe the new standard is the same as the pre-war Gold-Exchange Standard under a new name. But this option forms no part of the *permanent* scheme outlined in paras. 54—62. Para. 58 expressly states that the obligation is to convert the currency, *not merely into foreign exchange*, but into *metallic gold*, and it is an obligation that is not, as formerly, conditional and circumscribed, but absolute and unlimited? It is a mistake to imagine that "withdrawals from the currency will take place *only for export*". Paragraph 60 reads as follows: "Since gold bars are to be given in exchange for notes or silver rupees, *not for export only* but for any purpose, this is not an exchange standard; it is an absolute gold standard. Nevertheless the compensatory mechanism of the exchanges, is preserved, because gold bars are not currency. *When gold bars are given by the currency authority for notes or rupees, the currency is contracted*, while on the other hand, when gold bars are given to the currency authority for notes or rupees, the currency is expanded".

The Commission rightly considers it anomalous that one form of note, the paper note, should be convertible by law into another form, the silver note, and therefore recommends that the paper currency should cease to be convertible by law into silver coin. So strong is the suspicion against the Commission that this has led some writers to state that "the Currency Commission of 1926 advises us to start inconvertible notes". The truth is just the opposite of this. Today, the currency note is *really inconvertible*, being convertible only into an inconvertible coin—the rupee. Under the new standard both the note and the rupee will be *convertible* into gold *bullion*. Far from inaugurating a regime of inconvertible paper, the Commission *puts an end to it*. The Commission

*See Brij Narain's Indian Currency Reform.

says rightly—"That no opportunity for the termination of this obligatory convertibility is likely to be so favourable as the present, when, *by making the notes convertible into gold bars for all purposes, a more solid right of convertibility is attached to them than they ever had* since silver ceased to be a reliable standard of value". So obsessed some men are with gold currency, that they have seriously argued that under the gold bullion standard the rupee should not be called 'convertible' because the Currency authority will give in exchange for it gold bullion which is not legal tender, and in amounts worth not less than Rs. 23,000. If we are to follow this reasoning, we must consider England to be on an inconvertible paper standard because sterling to-day is convertible only into gold bars of 400 oz. Judged by this test, there has been no such thing as a restoration of gold standard in England. If we are to twist words out of their natural meaning in this fashion, there can be no end to hair-splitting.

UNANIMITY ON OTHER POINTS.

The Commissioners are agreed on several other points discussed in Part II of the Report. All sections of public opinion will probably welcome their recommendations that "the coinage of rupees should be stopped for a long time, until the amount of silver rupees in circulation is reduced to the amount required for small change" (Para 69); that the Paper Currency Reserve and the Gold Standard Reserve be combined into a single Reserve; that the proportion and composition of this Reserve be fixed by statute; that its silver holding be reduced from 85 crores to 25 crores in 10 years; that the amount of the Government of India securities be limited to 50 crores; that "created securities be replaced by marketable securities within a period of 10 years"; and that Saving Certificates "redeemable in three or five years in legal tender money or gold at the option of the holder, be introduced to encourage saving" and "bring home to the masses that gold is the standard of value of the rupee and that the one is convertible into the other."

THE RESERVE BANK.

Part III of the Report also reveals substantial agreement on fundamentals. All condemn the interference of government in the working of the Indian Currency System and agree that both currency and credit should be controlled by one central authority, *viz.*, a Central Bank. Sir Purshottamdas also concedes that the new

Reserve Bank proposed by his colleagues "is perhaps the ideal system" (Para 61 of the dissenting note). He, however, is of opinion that "the ends in view, as far ahead as we can see, will be better served by developing the Imperial Bank of India into a full-fledged Central Bank". If the system recognized by the dissenting member as 'ideal' is practicable—and no reasons are assigned why it should prove impracticable beyond the expression of a doubt whether "for some years to come, there will be any scope for two banks working side by side, one fully, and the other partially, with Government support"—one wonders why one should fall back on the second best. Apart from this, it is doubtful if the Imperial Bank will ever consent to a serious curtailment of its profitable commercial business which its transformation into a real State Bank will necessarily involve. Nor will its share-holders content themselves with dividends ranging between 5 per cent. and 8 per cent. as proposed in the case of the Reserve Bank, and agree to give the lion's share of the profits to Reserves and Government. It is fairly certain that the Imperial Bank will refuse to allow its constitution to be modified so as to ensure its observance of a national policy in currency and banking matters or to safeguard Indian interests; and that Indian public opinion will refuse to agree to Sir Purshotamdas' proposal to add another 2 per cent. to the huge dividends which the shareholders of the Imperial Bank have been earning at present owing to the grossly unfair arrangement under which the Imperial Bank has the use of Government funds, free of interest, without sharing its profits with Government, while claiming payment for its services in respect of public debt. In the face of these difficulties in negotiating with the Imperial Bank a satisfactory agreement, the Commissioners wisely chose the alternative of recommending the creation of a new Reserve Bank. The main outline of its charter is admirably drawn up by the Commissioners and the only unsatisfactory part of the Commission's recommendations under this head is their slavish acceptance of the Genoa Conference resolution that 'Central Banks should be free from political pressure.' There is no *real analogy* between the political conditions here and those prevailing in democratic countries of the West. There the pressure of supremely conscious democratic forces is so great as to make it impossible for the Central Banks to follow the lines of prudent finance. Here in India we need safeguards against the all-powerful European financiers and capitalists who are likely to dominate the Central Bank and the money-market. The only safeguard against this contingency lies in leaving the door free for

the people's will to assert itself through the influence of the Legislature on the Executive, and through the control of the Executive over the Central Bank. To exclude the members of the Executive and the Legislature from a voice in the Bank's affairs would, therefore, be a highly unwise step.

THE 18*d.* RATIO.

Part IV of the Report is the *only* portion to which strong exception can rightly be taken. It is perfectly true that the Indian exchange rose automatically between July 1924 and October 1924 as a result of the rise in world prices. But when the world prices began to fall after February 1925, Indian exchange would have automatically *fallen* if Indian prices had been stabilised just as was done when world prices rose between July and October 1924.

If the adjustment of prices, wages and taxes to 1*s.* 6*d.* rate was so complete as the Commission believed it to be, one fails to understand why the Government revenue has not fallen as a result of this adjustment of prices to the rate. "The very fact," rightly retorts Sir Purshottamdas, "that Sir Basil Blackett looks upon the increased revenue accruing from a 1*s.* 6*d.* rate as a tangible revenue, worth even naming for purpose of discussion of the ratio, shows that he is not quite convinced that this adjustment to a 1*s.* 6*d.* rate is complete."

The Commission agrees with Prof. Cassel and Mr. Kitchen that the future trend of gold prices is likely to be downward. If that is so, why not mitigate the severity of the fall by lowering the ratio to 1*s.* 4*d.*? It is true, that India cannot escape altogether the risk of a fall of prices if she adheres to a gold standard; but why not postpone that inevitable fall by allowing exchange to go down to 1*s.* 4*d.*?

But the strongest argument against the Commission's recommendation is that it seeks to nullify almost entirely the *protective* effect of our tariff. India is entitled to the *benefit* or the *burden*, call it what you will, of the tariff wall which the Legislature has laboured so hard to raise since the war. Had our pre-war system continued, the tariff changes since the war would have had the effect of raising *the Indian price level higher than the English*. As a matter of fact, our prices since the war have not risen *relatively* to English prices, thanks to the policy of our currency authorities. Prices having been prevented from rising higher than the English prices, the tariff has raised *exchange*, instead of *prices*; for if you control exchange, tariff tends to raise prices; if you control prices, it raises exchange.

The problem now before the country is how to retain the benefit of the tariff. If 1s. 6d. rate is adopted, it will be necessary for us to raise our tariff further in the interests of our industries. Whether we raise the tariff or stabilise exchange at 1s. 4d., the effect is just the same; prices will rise, inflicting unmerited injury on certain classes. The only way to escape from a rise of prices and yet have the benefit of the tariff is to maintain steady prices for some time to come, allowing exchange to go *down* to 1s. 4d. under the influence of *falling* world prices.

III.

THE GOLD BULLION STANDARD
AND
OUR PRE-WAR CURRENCY SYSTEM.*

None of the recommendations of the Commission has been more widely misunderstood than their proposal to introduce in India the Gold Bullion Standard on the basis of the English gold Act of 1925. Although supported by *all* the commissioners including Sir Purushotamdas Thakurdas, a very large section of the Indian Press and public opinion has received it with open hostility. The Indian Merchants' Chamber goes to the length of opining that the "gold exchange standard recommended by the commission is even worse than the pre-war gold exchange standard because the pre-war system was confined to sterling currency only while the new system proposed offering the currency of any country with a free gold market, involving the holding of our currency reserves in several countries". "The Bombay Chronicle" sees "nothing new in the scheme except that the obligation is now recommended to be statutory" and thinks that "in practice the obligation will be utterly ineffective for the Indian currency authority will, in normal times, have little occasion to sell gold as the credit balance of India is usually very large, and therefore, India requires to sell no gold for use abroad." "The Indian Daily Mail" regards the suggested new standard as "by no means an improvement on the present gold exchange standard" and feels that "the Currency Commission have deliberately gone out of their way to invent a system which is really a managed system though it is made to look like an automatic one".

THE MAIN DEFECT OF THE PRE-WAR CURRENCY SYSTEM.

Views of this sort betray a complete lack of understanding of the fundamental difference between a gold exchange standard and the gold bullion standard, recommended by the Commission. The main defect of our pre-war currency system lay in the fact that it was not *automatic in contracting* currency. *Legally*, the rupees were never *freely* convertible into gold *inside the country*; nor were they externally convertible except on those rare occasions when Government sold Reverse Councils at times of weakening

*This embodies much of what appeared in my contributions to 'The Hindustan Times', August 22nd, 1926 and to 'The People', September 12th, 1926.

exchange. And exchange is capable of being influenced by many factors, other than internal conditions of trade. Trade may be depressed and currency may be redundant, and yet heavy and continuous borrowing on the part of India may reverse the tendency to weak exchange. Currency may be over-issued and prices may rise in India and yet exchange may not only remain stable but even rise because of the greater inflation in other countries. Nor was our pre-war exchange standard as satisfactory in expanding currency as an automatic gold standard. Under it, the currency of India was expanded, not in response to the demands of trade as a whole but only of a part of that trade, namely, *external trade*. Even this statement needs to be qualified. India is a land of seasons; and it is only in the busy season that there is a keen demand for Council Bills necessitating fresh coinage of rupees or further issue of paper money. Thus the currency of India was in pre-war days expanded, not in response to the growth in external trade *throughout the year*, but only in proportion to the demand for funds for financing export trade during the *busy season*. The idea underlying our pre-war exchange system, that the *rate of exchange* is the test of deficiency or redundancy of currency is wrong and mischievous. Exchange is the measure of the temporary requirements of foreign trade but it is the *rate of discount* that is the proper index to the temporary requirements of India's internal trade. Exchange may show the scarcity or abundance of currency in one country as compared with another; but it is *the fall or the rise in the price-levels* of a country that reveals insufficiency or redundancy of the currency for the *normal* requirements of its total trade. The expansion and contraction of our currency under our pre-war gold exchange standard was thus not as natural and automatic as it would have been under a full-fledged gold standard; and consequently the over issue of our rupees and notes was just as likely as an over issue of inconvertible paper in some countries. Our pre-war standard of currency therefore failed to satisfy the most essential requisite of a sound currency *viz.*, *stability of purchasing power*.

THE GOLD BULLION STANDARD FREE FROM THIS DEFECT.

Now, *convertibility* into gold is the best safety valve for redundancy of currency; it provides the easiest automatic danger-signal to the currency authority when it is inflating the currency. When the purchasing power of the rupee or the notes tends to fall relatively to its fixed gold equivalent under a system of convertibility, rupees

will be exchanged for gold and *withdrawn from circulation*. Such a system of convertibility will not need *a large stock of gold if the British sovereign ceases to be legal tender*. For, if the rupees in circulation are diminished *and not replaced by gold coin* the value of the rupee *will rise quickly* to the point where it will cease to be profitable to exchange rupees for gold. This is the real rationale of the suggested Gold Bullion Standard. It will secure at least cost the automatic expansion and contraction of our currency in accordance with the varying needs of our total trade and link it with gold.

It is a grave error to argue that "the obligation to sell gold will be ineffective for the currency authority will, in normal times, have little occasion to sell gold, as the credit balance of India is usually very large and therefore India requires to sell no gold for use abroad." This is to commit the same mistake as the official apologists of our pre-war system frequently indulged in. A favourable balance of trade is not a correct measure of the country's requirements of currency for internal trade. A continuously favourable balance of trade does not mean that the country will *never need to contract currency*. The obligation to sell gold will be effective whenever the currency needs to be contracted or whenever the purchasing power of currency tends to *fall* below that of its fixed gold equivalent and not merely when India requires to sell gold for use abroad.

THE SECOND MAIN DIFFERENCE.

The second distinguishing feature of the Gold Bullion Standard is that unlike our monetary standard in pre-war days it is *not a dependent standard*. Under it, our currency will be linked not with any *foreign currency* but directly with *gold*. It avoids the mistake committed by the authors of our pre-war currency system of "linking the maintenance" of our standard of value "with the incidental and varying circumstances of exchange," and of placing it at the mercy of currency and credit changes in England. It is a mark of *superior* and not *inferior* status, for only the great nations of the world are operating the gold bullion standard to-day, the smaller one working on a gold-exchange system.*

THE THIRD DISTINGUISHING FEATURE.

There is another fundamental difference between our pre-war exchange standard and the Gold Bullion standard. The pre-war

*See 'The Statist' of November 6, 1926 page 697.

system of Indian currency impeded the automatic working of the natural correctives to favourable and unfavourable exchange; while the Gold Bullion standard is more effective in this respect than even a Gold Currency standard. When the United States has a favourable trade balance and gold flows from London to New York in adjustment of this balance, gold prices tends to *rise* in the United States and fall in England. This stimulates exports from England to the United States and tends in its turn to bring about a rate of exchange, favourable to London. When India had a favourable trade balance, the sale of council drafts tended to raise prices in India but *did not produce a fall of prices in England as gold did not leave England*. Similarly, even when currency was contracted by the sale of reverse councils at times of weakening exchange, no *additional* gold flowed into the United Kingdom with the result that prices in England did not tend to *rise*. As now admitted by Sir James Brunyate, "a correctly operating system for remedying exchange should be not only *deflationary* in its *local* effect but also *inflationary* in its *external* effect."^{*} This essential requirement was *not* met by the issue of sterling or gold credits under the exchange standard *but is met by the export of gold under the gold bullion standard*.

THE FOURTH ESSENTIAL DIFFERENCE.

Another important difference between our pre-war exchange standard and the gold bullion standard lies in the fact that the latter relieves us from the embarrassment of providing a large reserve in *silver*. Our notes are today convertible in silver rupees which are of no use for payments abroad; the new notes of the Reserve Bank will be convertible into *gold*—a universally acceptable commodity. To ensure convertibility, the currency authority today locks up a large part of its reserves in silver coin or bullion; to achieve the same objects the Reserve Bank shall have to accumulate substantial reserves in *gold*. So long as notes are convertible only in rupees, the rupee is the real standard of value; when both rupees and notes are freely convertible into gold, gold will be the standard of value. So long as notes are convertible only in silver coins, it will be difficult, if not impossible, to accumulate sufficient gold to embark safely on a gold currency standard; when on the other hand, the gold bullion standard under which notes will be backed by gold is in working order for a few years, it will be an easy matter to introduce a gold currency if the demand for it persists.

^{*} See page 501 Vol. III Appendices to the Report.

One of the main obstacles that stands in the way of introducing a gold currency today is the large amount of silver in the reserves; that is a legacy of our pre-war exchange system. The gold bullion standard will leave no such embarrassing legacy behind.

THE REAL TESTS OF AN EFFECTIVE GOLD STANDARD.

It is wrong to call this automatic Gold Bullion Standard an exchange standard only because gold is not in circulation as currency. This is to forget that the internal currency is freely convertible into gold internally and not merely into gold exchange externally. Mr. Benjamin Strong, the Governor of the Federal Reserve Bank of New York warned the Commissioners against the danger of "our attributing rather conventional or *proforma* meaning to the words "gold standard" and "gold exchange standard", and emphasised rightly that the "essential elements of a full gold standard are complete convertibility of the note issue into gold, an absolutely free gold market, an unfettered foreign exchange market, and a banking system which effectively assimilates gold imports and regulates the consequences of gold exports. Actual circulation of gold coin or its equivalent has been a usual feature of a complete gold standard, but is in no sense essential thereto, and as a constituent of the circulating medium, gold coin was becoming steadily less significant in the years preceding the world war." Judged by the tests laid down by this high authority, our pre-war gold exchange standard was *not* a gold standard; while the standard recommended by the Commissioners has every right to be called a "full gold standard."

The peculiar virtue of the pre-war gold standard in England did not lie in the fact that England had a gold coin in circulation, but in the fact that all other kinds of money in use in England were ultimately convertible into gold money and its gold money was itself convertible, by melting or export, into ordinary gold bullion. The merit of the Gold Bullion standard is that it provides for the convertibility of currency *directly* into gold bullion without the intervention of a gold coin. In respect of effective convertibility, it is thus actually superior to a gold currency standard.

Let me at this stage invite the attention of the public to the following remarks of Prof. Gustav Cassel, the well known currency expert who has taken considerable part in the various schemes of monetary reconstruction in the world:—"A gold standard is in its essence an abstract standard where the price of gold has been fixed, not absolutely, but so far that variations of the price are restricted within very narrow limits. This is the same as to say that the unit of the currency has an

approximately fixed gold value. *The fact that the unit of the currency is in such a way connected with gold is what essentially characterises the gold standard. All other traditional attributes of the gold standard are of entirely subordinate importance.* After the great revolution in the world's monetary systems, the fixed gold parity stands out more clearly than ever as the *only lasting and necessary feature of the gold standard. The new currency system of England is an expression for that purification of the conception of the gold standard which has now taken place.* According to this view, a rupee stabilised at the value of 1s. 6d. is essentially a gold standard. To combine the introduction of such a gold standard with a series of measures of a merely conventional character is, in fact, to go back to the ideas of the gold standard which prevailed in the monetary reforms of the 'seventees' of the last century. Among unnecessary accessories of the gold standard is particularly to be reckoned the introduction of gold coins in the circulation. Sweden has never allowed herself such a luxury and still has always been able to maintain her gold standard in a very satisfactory state, except for the period of war disturbances. India ought to refrain from the use of gold as a circulating medium not only because it is too expensive, but also because an Indian demand for gold for that purpose would, as explained above, mean an intolerable aggravation of the scarcity of gold for the world at large."

MISCONCEPTIONS.

One of the critics of the new proposal believes that Mr. Lindsay's Gold Exchange System is essentially the same as the Gold Bullion Standard. But notes and rupees were *not* freely convertible into gold *inside* the country under the Lindsay Scheme; they are under the Gold Bullion Standard. The substitution of sterling money for gold bars marks a fundamental difference, the one makes the *rate of exchange* the test of deficiency or redundancy of the currency; the other the "deviation in the *internal purchasing power* of the monetary unit from its parity with gold."

The pre-war Gold Exchange System is rightly described as a "system of inconvertible money", but the Gold Bullion Standard must not be confounded with the Exchange System and placed in the category of inconvertible money. Under the Gold Exchange System, our currency notes were really inconvertible, being convertible only into inconvertible notes printed on silver; but the Gold Bullion Standard makes the notes convertible into gold bullion instead of into inconvertible token coins of silver and so attaches to them,

in the words of the Commission, "a *more solid right of convertibility* than they ever had since silver ceased to be a reliable standard of value". To say then that "the Currency Commission of 1926 advises us to start with inconvertible notes" is either a perversion of language or a misrepresentation of the Commission's recommendation. To call notes convertible into gold bullion "inconvertible," is to give a dog a bad name and hang him. To place convertibility into gold bars on a par with convertibility into acres of land, maunds of wheat or tons of coal is ridiculous*; to borrow the favourite expression of a critic the distinction is pointed out "even in elementary text-books of economics for beginners". Convertibility of currency into *gold bars* serves the same essential purpose as its convertibility into *gold coins*; both maintain parity between the purchasing power of gold and the purchasing power of the unit of currency; both secure automatic expansion and contraction of currency. If it is true that "there has been restoration of Gold Standard in England in the sense that English paper money is convertible into gold bars;" it cannot be denied that the Gold Bullion Standard recommended by the Commission will establish in India as good a Gold Standard as England has at present, and that our notes under the Gold Bullion Standard will be no more inconvertible than the Bank of England notes are under the Gold Act of 1925. It is true that the holder of a ten-rupee note will not be able to convert it into gold directly at the Currency Office; but similar is the position of the holder of a pound-note in England. But as Dr. Cannan points out in a letter to the present writer, "there is no difficulty about collecting large numbers of these units, and then conversion becomes worth while. If ten thousand rupees (23,000 under the Commission's recommendation) are convertible, that will secure that each of the ten thousand is worth whatever the conversion rate prescribes." The chief merit of the genuine Gold Standard undoubtedly is that "it works automatically"; but in this respect the Gold Bullion Standard is as automatic and therefore as genuine as the Gold Currency Standard.

Dr. Cannan's authority is sometimes cited in favour of the erroneous views that there is no essential difference between *our pre-war exchange standard* and the Gold Bullion standard*. As a matter of fact what Prof. Cannan said in his evidence was something quite different, as the following extract from his evidence will show:—

Q 13,209. Will you explain to us in what respects the gold *currency* standard is simpler and less liable to be broken

*See Brij Narain's Indian Currency Reform pp 6.

down?—I should have thought it was fairly obvious why it is simpler'.....

Q 13,210. If I may suggest a comparison, *not with the system which has hitherto prevailed in India* but with a simple gold exchange standard based upon an obligation on the part of the Central Bank to buy and sell at fixed rates the means of international payment, what would you say to that? ———I think when you get on to the bare bones of the gold exchange system there is very little difference between the two. Some people say that this country is on a gold exchange standard system now.

Q 13,211. Then I rather take your answer to mean that if the gold exchange system is defined with sufficient precision and reduced to its most scientific minimum, there is, in your opinion, no great difference in simplicity between that and the gold *currency standard*?—' There is not really, but I doubt very much whether the ordinary person will be able to understand it as well even then.

To a certain extent the confusion of Gold Bullion Standard with our pre-war exchange standard is due to a difference of opinion in the matter of nomenclature. An Indian critic prefers to call the present English Gold Standard an inconvertible paper standard; Dr. Gregory calls it "a Gold-Exchange Standard" in his "Return to Gold"; Dr. Cannan considers the application of the term 'Gold-Exchange Standard' to the English Standard as unsatisfactory "because it has other associations and the "gold" in it was some foreign currency based on gold, rather than gold as such." (*Economic Journal* Dec. 1925); the Currency Commission names it as a Gold Bullion Standard. Call it by whatever name you will, the fundamental questions are: Whether it will give us as stable a standard of value as a gold currency in circulation; whether it will be as automatic in its working. So long it satisfies these two essential tests, it matters little what name you give it.

*See page 6 Brij Narain's Indian Currency Reform.

IV.

CONTRACTION OF CURRENCY

UNDER

THE GOLD BULLION STANDARD.*

Attempts have been made to belittle the virtues of the Gold Bullion Standard on the ground that it provides for contraction of currency not for 'all purposes' but only "for export". The critics contend that this is the *real* meaning of paragraphs 64 and 150 and Schedule I of the Report. A careful perusal of the references cited will show that there is nothing in them to justify the critics' inferences. Paras 64 and 150 deal with the *rates* for buying and selling gold and aim at finding out the rates that will prevent "the currency authority from becoming the *cheapest* market for gold in India in all ordinary circumstances," and so "practically destroying the wholesale bullion market." In order to achieve *this object* (and not avoid the *internal convertibility* of the currency) the Commissioners propose "to fix the selling prices of gold at rates which will enable the Bank *to replenish its stock of gold without loss* by importation from London." It is only to ensure the internal convertibility of rupees and notes that the Bank will have to replenish its stock of gold in this way. Refusal to sell gold at a price *exactly* corresponding to the par value of the rupee *does not at all imply refusal to convert rupees and notes into gold at rates* "which will enable the Bank to replenish its stock of gold without loss by importation from London." The Commission objects to the first but agrees to the second. *At the rates recommended* "the gold bars are to be given in exchange for notes or silver rupees, *not for export only but for any purpose*"; and *when at these rates* "gold bars are given by the currency authority for notes or rupees, *the currency is contracted*." This is what para. 60 read with para. 64 really means. Nor does the sentence, "the reserves exist to assure the maintenance at parity with gold of the *'purchasing power* of the monetary unit, *i.e., to meet purely monetary needs*" mean, as a critic assumes it to mean, that these reserves exist only to maintain the *external* value of the currency. The expression "the purchasing power of the monetary unit" means the purchasing power of the rupee, *'both internally and externally'*, as is explicitly stated in paragraph 114. Of the two, the Commission

* See Brij Narain's Indian Currency Reform Chapter II Part I.

considers the *internal* stability of the rupee as the more important ; for "*internal* stability is the main factor to achieve external stability" (para. 115.) "If the purchasing power of the rupee falls below that of its gold equivalent, the only way to restore its parity with gold is to contract the currency; that is the time when the gold reserves will be utilised for withdrawing currency. If people want bullion not because currency is redundant but because they need it for non-monetary purposes, they must buy it from the bullion market at the market rate or from the the currency authority at rates which will enable it "to replenish its stock of gold without loss by importation from London." The currency authority is to keep reserves not in order to meet the bullion needs of India but in order to withdraw currency when it is in excess of the country's requirements or rather when its purchasing power tends to fall below that of its bullion equivalent. If under any circumstances people call upon it to meet their bullion needs, it can only do so by importing gold from abroad and will therefore charge rates which will ordinarily make it more profitable for people to buy gold from the bullion market.

RELEVANT EXTRACTS.

Perhaps the best way to set the doubts of the public at rest on this point is to let the following extracts from the Report speak for themselves:—

Paragraph 54:—The essence of the proposal which we proceed to develop is that the ordinary medium of circulation in India should remain as at present the currency note and the silver rupee, and that the stability of the currency in terms of gold should be secured by making the currency directly convertible into gold for *all* purposes, but that gold should not circulate as money.

Paragraph 58:—The obligation is to convert the currency, not merely into *foreign exchange*, but into metallic gold, and it is an obligation that is not, as formerly conditional and circumscribed, but absolute and unlimited.

Paragraph 59:—We propose that an obligation be imposed by Statute on the currency authority to buy and sell gold *without limit* at rates determined with reference to a fixed gold parity of the rupee but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold is required. The fulfilment by the currency authority of this obligation will secure the stability of the gold value of the rupee, and the stability of exchange within

gold points corresponding to the selected parity. Gold is thus made the standard of value. The rupee is linked to gold and *not to sterling* or to any other currency or group of currencies.

Para 69:—Since gold bars are to be given in exchange for notes or silver rupees, *not for export only*, but for any purpose, this is not an exchange standard; it is an absolute gold standard. Nevertheless the compensatory mechanism of the exchanges is preserved, because gold bars are not currency. When gold bars are given by the currency authority for notes or rupees, the currency is contracted, while, on the other hand, when gold bars are given to the currency authority for notes or rupees, the currency is expanded.

Para 61:—The statutory obligation to buy and sell gold for rupees without limit at a prescribed parity for the first time in the history of the rupee will base it on gold firmly, and in a manner that is conspicuously visible. It establishes the principle that gold is the standard of Indian currency at a fixed ratio, that the currency authority admits it, and must maintain it.

Para 64:—If the currency authority were compelled to sell gold *at a price exactly* corresponding to the par value of the rupee, it would at once become the cheapest market for gold in India in all ordinary circumstances, for a selling price so determined would take no account of the costs of importation nor of any deviation in the value of the currency from its gold parity. Apart from practically destroying the wholesale bullion market, the currency authority would inevitably become involved in the performance of a task which does not properly belong to it.....It is essential, therefore, that the condition which are to govern the sale of gold by the currency authority should be so framed as to free it in normal circumstances from the task of supplying gold for non-monetary purposes. In order to achieve this object we propose to fix the selling prices of gold at rates which will enable the Bank to replenish its stock of gold without loss by importation from London. Thus, when exchange is at the upper gold point the selling price for delivery at Bombay will be the par value i.e. Rs. 21 as 3 ps. 10 per tola. When exchange is below this point, the Bank will be required to sell gold for delivery in London or Bombay, at the option of the purchaser, at certain notified prices.

Para 150:—The Bank shall sell to any person who makes a demand in that behalf at its offices at Bombay, Calcutta

or Madras, during the office hours of the Bank, and pays the purchase price in any legal tender money, gold bullion for delivery at its Bombay Office at the price of Rs. 21 as. 3 ps. 10 per tola of fine gold, but only in the form of bars containing approximately 400 ozs of fine gold. Provided that whenever the market rate for the selling price of telegraphic transfer on London is less than the upper gold point of exchange as defined below, the Bank shall sell gold as aforesaid for delivery at its office at Bombay or in London at the option of the purchaser at prices hereinafter called the notified prices."

Para 3 schedule 1 :—It cannot be assumed that, in the case of India, gold movements can be confined to those for purely monetary purposes; unless, therefore, the Central Bank is relieved of the necessity of supplying gold within the two gold points of the exchange, it would be exposed to a constant drain upon its gold reserves for purposes other than those for which they are held. . . . The reserves exist to assure the maintenance at parity with gold of the purchasing power of monetary unit, *i.e.*, to meet purely monetary needs. It is evident that, if they can be drawn upon in the ordinary course to satisfy non-monetary purposes to anything but a minor extent, the bank's primary task, *viz.*, to maintain the external value of the currency, will be jeopardised.

Para 5 schedule I—"It is required so to frame the bank's obligation to sell gold as to make it unprofitable for gold to be bought from it except in circumstances in which it would be profitable to do so for purely monetary purposes."

In reading schedule I, specially its first paragraph, it should be borne in mind that except as to the method of computing the buying and selling rates, it is not a part of the Report; that it cannot be considered as a part of the formal exposition of the gold bullion standard by the commission; and that the reason why only the movements of gold between one gold standard country and others are considered in the first paragraph and nothing is said about the in-flow and out-flow of gold due to changes in the internal demands for currency is that only the former were relevant to the purpose in hand, *viz.* the computation of buying and selling rates necessary for the purpose of preventing the currency authority from becoming the cheapest market for gold.

THE PRIMARY TASK OF THE BANK.

Evidently the critics have been misled by the sentence, "the Bank's primary task *viz.* to maintain the external value of the currency,

will be jeopardised" in para 3 of the schedule I into thinking that the maintenance at parity with gold of the *internal* purchasing power of the money unit is not intended to be one of the primary functions of the Bank and that the obligation to sell gold is intended only for securing the external value of the rupee. But in order to find out what is intended to be "the primary task of the Bank" we must go not to schedule I but to para 114 of the Report, which bears the heading "The Primary Task of the Bank". It reads as follows:—
 "The goal of all monetary policy is the achievement of stability of the purchasing power of the monetary unit, and the condition under which the sole right of note-issue is entrusted to the Bank must clearly be the obligation to maintain stable the *purchasing power* of the rupee, *both internally and externally*. This stability will find expression, internally in the stability of the general level of commodity prices, and externally in the stability of the purchasing power of the monetary unit in relation to gold To assure *this* stability, it is indispensable that the obligation should be put upon the bank at all times to buy and sell gold at fixed prices which are laid down in the charter." This explicit statement ought to set at rest the doubts of sceptics on this point.

PARA 115 OF THE REPORT.

The following sentence in para 115 of the Report has led one of the critics* to argue that the Commissioners themselves do not believe that currency will need to be contracted except in times of weakening change:— "And if the exchanges are stable and keep within the upper and lower gold points set by the fixation of the price at which the Reserve Bank undertakes to buy or sell gold, it will not be called upon either to buy or sell gold." A reference to para 115 of the Report will convince even a superficial reader that this sentence, *read with the context*, means something quite different from what the critic suggests. The concluding three sentences of the paragraph in question read as follows:—
 "It clearly follows that *stability of internal prices* in relation to the world level of gold prices will prevent those repercussions, and will therefore *prevent instability of the external value* of the monetary unit, that is, of the exchanges. And if the exchanges are stable, and keep within the upper or lower gold points set by the fixation of the price at which the Reserve Bank undertakes to buy and sell gold, it will not be called upon either to buy or sell gold. Provided, therefore, the Bank follows a judicious policy of limiting

* See Brij Narain's Indian Currency Reform page 5.

the monetary circulation to the actual need of the country by an appropriate credit policy, and so keeps the internal value of the rupee stable, the obligation to buy and the sell gold will cause it no embarrassment." It is plain that far from under-rating stability of the internal value of the rupee, the Commission has emphasised its importance over and over again. And no one can argue with any show of reason that currency should be contracted or gold given in exchange for rupees when *both the internal and external* value of the rupee remain stable.

VIRTUE OF CONVERTIBILITY.

It is perfectly true that if "the Bank follows a judicious policy of limiting the monetary circulation to the actual needs of the country by an appropriate credit policy and so keeps the internal value of the rupee stable" (Para 115), there will be no need, except sometimes for the purpose of export, to convert rupees and notes into gold bullion. But what will compel the Bank to keep straight or to realise forcibly the consequences of an injudicious policy? Precisely, this obligation to convert currency freely into gold. Convertibility is a safety valve; the fact that when things are managed wisely, there is no need for it, is no argument for denying that good management is ensured precisely because of the safety valve. It is convertibility *at fixed* rates, whatever the rates may be, that makes the gold bullion standard as 'knave proof' and 'fool-proof' as a gold currency standard can ever be. It is precisely because of this reason that the commission explicitly states that "To assure this stability (internal and external) it is indispensable that the obligation should be put upon the Bank at all times to buy and sell gold at fixed prices which are laid down in the charter" (para 114).

A GOLD CURRENCY AND THE RATE FOR CONVERSION.

Perhaps the best way to appreciate the reasons for the Commission's recommendation regarding these rates of conversion is to suppose for a moment that rupees and notes are made freely convertible into *gold coin*, instead of *gold bullion*. Will the critics then think of charging no seigniorage or so fixing the rates of conversion as to make the currency authority "the cheapest market for gold in India in all ordinary circumstances?" Will they not so frame the conditions governing the conversion of rupees and notes into gold coin as to free the currency authority "in normal circumstances from the task of supplying gold for non-monetary purposes and fix such rates of conversion "as will enable the Bank to replenish its stock of gold without loss by importation from London.?"

CONCLUDING REMARKS.

But granting for the sake of argument that the Schedule I is so framed as to deprive us of an honest Gold Bullion Standard, is that an adequate reason for insisting on a Gold Currency? Is it impossible for the Indian Legislature to secure a full and free convertibility of our currency into gold bullion for all purposes? Cannot our legislators reject all that may be objectional in Schedule I and accept the rest of the recommendations in parts 2 and 3 of the Report? If the critics' sole objection to the Commission's scheme lies in the provisions of paras 64 and 150 and Schedule I, let them suggest an amendment to Schedule I instead of condemning the principle of the Gold Bullion Standard.

THE QUESTION OF A GOLD CURRENCY.

The Currency Commissioners have unanimously rejected the scheme for the immediate introduction of a gold currency in India. The grounds on which they base their decision have been the subject of adverse comment in the country. A portion of the evidence of Mr. Montagu Norman, the Governor of the Bank of England, has been quoted in support of the view that a gold currency is not a sign of backward civilisation and will not be regarded as such in the future.* It is argued that the suggestion of "our Currency Commission that the change to gold is likely to upset the gold standard of the United States is non-sensical." It is maintained that the evidence of Dr. Sprague shows that the amount of gold required for the introduction of a gold currency in India, could easily be withdrawn from the United States without necessitating credit contractions and lower prices; and that England could spare some portions of its gold for us if it only chooses to take the risk of postponing amalgamation of the notes of the Bank of England and of the Treasury, a diminution in the supply of credit, a rise in the rate of interest, and a general fall of gold prices. It is suggested that "our Currency Commissioners have much exaggerated the effect of the reaction on India of a fall in gold prices". It is further contended that Mr. Denning's assumption that the price of silver was not likely to fall below 24d. by the sale of India's surplus silver amounting to three times the world's annual production is correct, because the experience of Germany between 1871-79 shows that the sale of 3½ kilograms of silver during these nine years produced a fall of only 15 per cent. in its price, in spite of some other circumstances which tended to accentuate the fall. Finally, it is said that it is possible to have an effective gold standard in India by merely stopping the minting of rupees and keeping the mints open to the free coinage of gold without providing for the convertibility of our currency into gold or limiting the legal tender character of the rupee.†

THE FIRST PROPOSITION.

It is difficult to see how the quotation from the evidence of the Right Honourable Montagu Norman is *relevant* to the main reason for the recommendations of the Commission. The

* See Brij Narain's India Currency Reform Part I.

† See the resolution of the Indian Commercial Congress.

Commissioners have never said that the circulation of gold is regarded by *all* experts as a sign of backward civilisation; nor have they said anywhere that it will be regarded as such after Mr. Montagu Norman's life-time. The exact words used by them are:—"some high authorities have expressed the view that the circulation of gold is beginning to be regarded as a sign of backward civilisation. It may well be that, when India is in a position to introduce gold in circulation, she will reject it as an obsolete idea, and will finally close the door which we have now propose to leave ajar; but that is a matter which we have neither the desire nor the capacity to forejudge" (Vide para. 57 of the Report) As practical men, they were concerned with what was immediately feasible and not what was practicable in the remote future or after the life-time of Mr. Montagu Norman. On this narrow issue, Mr. Montagu Norman's evidence is emphatically *against* the immediate introduction of a gold currency and not in favour of it. He explicitly states, "I rather suspect that so far as India is concerned, it (the time for the resumption of gold coinage) is equally remote". And even if the introduction of gold coinage be a sign of that prosperity which Mr. Montagu Norman trusted that "England may reach again after his life-time," can it be seriously contended by any body that India has already attained that prosperity which England might reach in the distant future?

But apart from this reasoning, are the critics sure that they are right in inferring from Mr. Montagu Norman's replies to questions 13,689 to 13,692 that he is opposed to the view that the circulation of gold is beginning to be regarded as a sign of backward civilisation? They will find themselves cruelly disillusioned by reading the following extract from Mr. Montagu Norman's evidence:—Q 14,451. (*Sir Reginald Mant*) Mr. Governor, may I refer for a moment to your dream, in which you look forward to the restoration of gold circulation in this country. We have received a good deal of the evidence to the effect that gold circulation is not a desirable thing, and that the present currency system in this country is theoretically preferable. Sir Charles Addis referred to it just now. Some of the advocates of the introduction of a gold circulation in India have said that they only regarded it as a temporary phase—that they regarded a note circulation as the ideal circulation and that they proposed to introduce gold currency in India with a view eventually to withdrawing it and reverting to a note circulation. Can you tell us why you regard gold circulation as an advisable thing in itself?—(*Mr. Montagu Norman*) *I do not think I do.*

Q 14,452. I thought you did :—No, I do not think I said so. When I was asked as to the possibilities of a gold currency in this country, I said that beyond my life-time conditions might make for its return so to speak, naturally and automatically, though my personal belief was that a *gold currency would come to be looked upon almost a sign of backwardness* as well as being uneconomic, and that at any rate the generation to which most of us in this room belong would not desire again to carry sovereigns in our pockets in preference to more convenient notes. That is my feeling.

Q 14,453. “Then your dream will never be fulfilled”—“I cannot say. I do not attempt to prophesy as to what will happen after our life-time. If I had my personal choice, I should always prefer to carry the convenient note rather than actual coin, and I think it has economic advantages as well.”

Q 14,454. “I thought from your previous replies that you considered gold currency a desirable thing”—“No, *I do not think I said that*. You can see what I did say. Have I answered you now?”

Q 14,555. Yes, I think you have made it quite clear.

THE SECOND PROPOSITION.

As to the second proposition, the passage on which the critics base this indictment against the Commission is capable of a different interpretation, which will give to the whole paragraph from which they quote, a meaning quite consistent with the evidence of the American witnesses, to which a specific reference is made by the Commission. What the American evidence led the Commission to believe is not that the change to gold in India would be likely to lead to a *breakdown* of the gold standard *both* in United States and Europe but that “it can only be accomplished at the cost of insecurity to those countries which have restored their monetary standards, and at the risk of delay to those countries which are now seeking with reasonable promise to do so”. Any fair-minded reader who reads the following extract from the evidence of Prof. Hollander, one of the American witnesses, with the relevant passage from paragraph 53 of the Report, reproduced below, will easily see that this is the only reasonable interpretation to put on the passage in question :—

(Prof. Hollander)—“It is possible, however, I think to summarise it in the statement, to which there would be general assent, that at this particular time, and through the only channels practically available, the drawing into India of the amount of gold proposed, can only be accomplished at the cost of insecurity to those countries which have restored their monetary standards, and at the

risk of delay to those countries which are now seeking with reasonable promise to do so, and that this uncertainty and delay are likely to produce higher interest rates, business disturbance and economic depression, with inevitable repercussions upon the economic well-being and commercial prosperity of India" (vide pp. 277 vol. III minutes of evidence.)

Extract from para. 53:—"It seems to us that the acceleration would be gained at the cost of risks far too great to be justified. We may conjecture that the authors of the scheme would come to the same conclusion, *after studying the evidence that we have received from the United States.* Sir Basil Blackett comes to meet such a decision when, in the last paragraph of his memorandum, he says: "If the effect of a decision to attempt the change to gold in India is going to be to upset the gold standard in the United States or in Europe, India has clearly nothing to gain by the attempt". In our opinion, the attempt would be very likely to have the consequence to which he refers. It can only be accomplished at the cost of insecurity to those countries which have restored their monetary standards and at the risk of delay to those countries which are now seeking with reasonable promise to do so, and this uncertainty and delay are likely to produce higher interest rates, business disturbance and economic depression, with inevitable repercussion on the economic well-being and commercial prosperity of India."

The very words used in the concluding sentence are taken bodily from Prof. Hollander's statement. The critics may accuse the Commissioners of plagiarism if they wish but they cannot in fairness accuse them of meaning anything more than what the American witnesses have said.

THE THIRD PROPOSITION.

The third proposition contains a number of assumptions, each of which has yet to be proved. Mr. Denning's scheme involves the reduction of the proportion of gold and sterling securities in the Reserve to gross note circulation during the transitional period of 10 years to 30 percent. Do the critics consider this low proportion safe for our currency system? The Commission thought that owing to a variety of reasons (Vide paras 39-45) there was an element of uncertainty in Mr. Denning's estimate of the amount of gold required for giving effect to the scheme, and that it was impossible to be sure that the additional demands for gold could be spread over a period of 10 years. The critics assume otherwise, for what reasons, they omit to state. So disinterested an expert as

Prof. Gustav Cassel finds fault with each of these estimates; he considers it unsatisfactory to calculate the gold requirements for the reserve on the basis of the present note circulation, and thinks that "the 30 percent. gold reserve required according to the scheme would at the end of 10 years represent not 56·9 crores but 113·8 crores"; he estimates the minimum amount of fresh gold required at the introduction of the scheme at three times the sum calculated by Mr. Denning; and concludes by saying "that the extra demand for gold caused by the proposed monetary reform could easily attain a figure several times higher than that assumed in the scheme—roughly about four years' world production of gold". This line of argument further assumes that India in the *only* country whose demand for gold is to be satisfied by the United States, or that the amount of free gold available in the United States is so much in excess of probable requirements of other countries for monetary reconstruction that 500 million dollars could easily be spared for India without leading to a fall of gold prices. The statement of Dr. Sprague, far from supporting this assumption, explicitly confirms the Commission's view that the stock of free gold in America cannot be regarded as superfluous if the probable requirements of other countries for monetary reconstruction and also the internal absorption of gold for the growing needs of the United States itself are kept in mind (Vide para 38), as can easily be seen from the following extract from his evidence :—

Q 15,293.....I have given a figure of free gold in the United States which may appear to you large...but this total of between a billion and a billion and a half of free gold does not appear to me to be large, when taken in relation to probable gold requirements throughout the world during the next 10 or 15 years.....It does not appear to me that the gold position is such as will warrant one in assuming that very stable prices can be maintained if as large a draft is to be made upon gold supplies as seems to be involved in the plan under consideration"..... (Vide pp. 295-6 296 vol. V. Evidence).

Q 15,313. . . "I am opposed surely to a gold currency for India, and indeed for any other country, because I consider that that is a backward step in monetary practice and I do not believe that there is sufficient gold available in the world to provide a gold currency and maintain something like the present level of prices."

Nor is it fair to the American witnesses to take a portion of their evidence, and base upon it a charge that their unwillingness to grant credits to India for the introduction of a gold currency was

due *solely* to their anxiety for the silver industry. Here is an extract from Prof. Hollander's evidence, which gives a different complexion to the whole affair.

Q 15,270....."If this were the only consideration involved, if it were clearly evident that this was a plan of great importance to the people of India, enabling them to realise something in monetary stability and further their industrial development, and was the only means of bringing that about, I think a very strong case might be made out in the United States among investors and perhaps with Government for sacrificing the silver industry. It is perhaps unfortunate to have introduced the silver problem at the outset, for it is by *no means our only consideration*, since we take definitely the position that even if the silver industry were not in question, we doubt whether a loan for the adoption of this particular plan would prove acceptable to the United States, because of other quite distinctive monetary defects in the plan that will be brought out a little later. . . . This silver matter is in a sense incidental. I am quite frank to say that in our first examination of the plan, the silver factor figured very large; but as we studied the plan more in detail and considered how we thought it would work, the silver matter faded rather in the background."

Be that, however, as it may, the refusal of the United States to give a loan to India for reasons of her own, national or international, or the unwillingness of the United Kingdom to take the risk of possible credit contraction, higher interest rates and a fall of prices, does not and cannot prove that the Commissioners were guilty of sacrificing India's interest to those of other countries. One of the severest of critics admits that "one could not quarrel with the Currency Commissioners, if they had condemned the scheme on the ground that it could not be worked without the assistance of the authorities in England and New York, which has been refused." This is precisely what the Commissioners have urged as one of their reasons for rejecting the scheme. Let the following extract speak for itself:—"In these circumstances it appears that insuperable difficulties would be encountered in obtaining the necessary credits. It must be pointed out that before adopting this proposal or any other proposal for the introduction of a gold currency into India, the authorities responsible for the scheme must be certain beyond the possibility of a doubt that they can carry the scheme through. For that purpose, they must be assured that they can obtain the amount of gold required. The evidence which we have received prevents any such assurance. In view of that evidence, we are confident that

those responsible for the scheme under consideration would be the first to recognise that the external conditions which are essential for the success of the scheme at the present time are not fulfilled." (para 51).

THE FOURTH PROPOSITION.

A critic* accuses the Commissioners of having exaggerated the effect of the reaction on India of a fall in gold prices and quotes in his support the reply of Mr. Montagu Norman to question 13,673. Had he cared to read a little further, he would have found to his surprise that the opinion of the Commission on this point is precisely the same as that of the Governor of the Bank of England. The relevant portion of his evidence reads as follows:—

Q 13,676. Assuming a general fall in gold prices as a result of this fresh demand for gold, what would be the reaction upon India as one unit in the world's trade system of such a general fall in gold prices." Would it be adverse or beneficial?—A fall in gold prices would, on balance, be, I believe, unfavourable to India, but as indicated in my previous answer, I think the effect would be mitigated, as compared with other countries, by India's favourable balance of payments, and the advantage she enjoys in the quasi-monopolistic nature of her exports.

And what does the Commission say? "In their reaction on India as one unit in the world's trade system, a fall in gold prices and a curtailment of credit would, on balance, be unfavourable (Para 37). Let the reader judge whether there is any real difference between the view of the Commission and the Governor of the Bank of England.

THE FIFTH PROPOSITION.

It is difficult to dogmatise on the future course of silver prices in the event of our selling our stock of silver. But such expert evidence as has been taken by the Commission, points to the conclusion that silver may fall below 24d. The report submitted by Arthur Norman and Captain H. A. C. Jenson show that "it is probable that the price of silver would be at least cut in half if the gold currency proposal were put into effect." Mr. Joseph Kitchin thinks in view of several considerations pointed out by him in his statement that "it would be bold to expect an average price of 24d. per standard ounce to be secured" (Appendix 82, Vol. III). Against the recent facts cited by these silver

* Prof. Brij Narain in The Hindustan Times.

experts, one of the critics prefers his own inferences from the German experience of 1871-9. During these years the sale of about $1\frac{1}{2}$ times the yearly production of silver produced a fall in price of about 15 per cent. Mr. Denning's scheme contemplates the sale of three times the world's supply of gold; and the critic thinks that Mr. Denning is right in assuming a fall in price from 33d to 24d. or a fall of 27, 3 per cent. But on the 6th of August 1926, the date on which the Report was published, the London price of silver was 28 $\frac{1}{2}$ d. (cash) and not 33d. Even a fall of 27.3 per cent would bring down the value below 24d. And this takes no account of the effect of exchange of silver hoards for gold or the possible effect on China. As a matter of fact, the price of silver actually went down to 24 d. in October 1926, without an ounce of silver being sold by Government. The course of silver prices has more than justified the fears of the Commission.

THE LAST PROPOSITION.

The last proposition confounds "*effective* gold standard" with limping bimetallism. Unless the currency of a country is freely convertible into gold, there can be no *effective* gold standard at all. It is possible to work the standard suggested in a period of *rising* world prices; but it is not possible to do so in a period of *falling* world prices, for in the absence of any automatic process of contracting currency, it will then be impossible to maintain parity between our currency and gold. As both the rupee and mohur will be unlimited legal tender, Gresham's Law will operate in times of redundancy of currency and prevent gold from circulating at all. If, on the other hand, world prices show an upward trend, the course suggested will provide only a *temporary* solution, for rupees will have to be re-minted as long as the silver coin continues to be the most suitable and acceptable medium of exchange. In any case, the standard proposal will be far less satisfactory than the gold bullion standard in so far as it provides neither for the automatic withdrawal of token currency nor for "the strengthening of gold reserves, at the maximum rate, and to the maximum extent possible under present conditions without upsetting prices, incurring excessive expenses, or injuring Indian trade by unduly restricting credit."

SOME ASPECTS OF THE RATIO CONTROVERSY*.

The battle of the ratio continues to be fought with greater vehemence than ever. The Currency League has enlarged its object with a view to draw in its fold almost everybody who differs from the findings of the Currency Commission and thus present a united front to Government. The funny part of the whole show is that men who really differ in vital points are speaking from the same platform, and though apparently supporting one another are in reality attacking the grounds advanced by their own colleagues. On the 21st of November last, Sir Victor Sassoon announced that "there was general agreement that gold standard and gold currency were not immediately practicable"; that they did not wish "to arouse any alarm in foreign countries"; and that "the fall of world prices does matter to the well-being of the agriculturist." And yet most of the other speakers of the Currency League have openly declared themselves in favour of the immediate introduction of an effective gold standard with gold currency in circulation. The Currency League has been doing a lot of propaganda work over the alleged huge losses to the agriculturist; while one of its main supporters is reported to have said that "the prices of agricultural produce have not been adjusted to 1s. 6d. ratio." How the agriculturist could suffer an actual loss on account of the ratio except when prices *fall* and the cost of production remains the same, this merchant-prince never cared to explain. The ratio question has all along been the centre of agitation and yet one of the best champions of the Currency League has been making frantic appeals to his colleagues "to give up this foolish, superfluous, mistaken fight for the ratio in favour of the larger question of the standard itself." The worst feature of the agitation is the spirit of intolerance it has fostered; if you agree with the Currency League, you are dubbed a patriot; if you differ, you are accused of having an eye on Government favour in case you are young, and of suffering from well-deserved decay in case you happen to be old. Instead of educating the public in currency matters, the League leaders have either confused the lay public by stating all sorts of half truths or misled them into thinking that it is the old, old question of England *versus* Indian interests. Ask an average member of the public if he is for stabilising at 1s. 6d. or "1s. 4d., he will unhesitatingly say, "1s. 4d."; ask

* An address before the Delhi University on the 19th January, 1927 under the chairmanship of The Hon'ble Sir Basil Blackett, K.C.B., K.C.S.I.

him again if he wants dear bread or dear cloth, he will with equal vehemence and honesty of convictions declare himself in favour of cheap food and cheap cloth. Ask an average business man or a factory owner, "Do you want a gold coin?" he will jump up and say, "Aye"; question him again and ask, "Do you want falling prices for a longer period?", he will look with holy horror and cry, "No, certainly not". This is the real measure of education the Currency League has given to the public. Politicians and businessmen have an inveterate habit of indulging in special pleadings; and amidst their shouts, the voice of the academic economist is only too likely to be lost. Yet he must make an attempt, however feeble, to make himself heard if he is to remain true to his own work. In a series of articles contributed to the local "Hindustan Times" and "The People" of Lahore, I stated as briefly as possible my view of the main recommendations of the Royal Commission on Currency; but in view of the widespread errors on the question of the rate and the spirited controversy over it, let me take this opportunity of dealing at some length with some aspects of this ratio controversy. I trust that while listening to me you will attempt to brush aside for a while all your preconceived notions on the subject, specially your prepossessions in favour of the Currency League and your prejudice regarding sinister influences from England.

EFFECTS OF A RISING OR FALLING RUPEE.

At the outset, let me repeat what must be familiar to all who have read the evidence of the late Prof. Marshall and Sir Robert Griffen before the Fowler Commission and what I emphasised again in my evidence before the Hilton Young Commission. Other thing remaining the same, a depreciating currency or falling exchange tends to stimulate exports and discourage imports. But the advantage to the exporters is largely at the expense of the other classes of the community and can be only temporary. The common opinion that a depreciating exchange was for the benefit of an export trade, rests on the natural habit of regarding the interests of the Entrepreneur as co-extensive with those of the trade. What really happens when a currency is depreciating is that a person who is under obligations to make certain currency payments fixed by definite contracts or by custom, is allowed through the change in the value of the currency, to discharge those obligations at less cost to himself and less benefit to those who are engaged with him in trade. There is no doubt that a fall in the value of the currency is a bounty, but it is a bounty not to the export trade but to *one class* in the export trade at the expense of

the other classes engaged in it. Just the opposite is the effect of an appreciating currency.

But these effects are only temporary. The depreciating rupee is advantageous to exporters only so long as the cost of production and prices in India do not rise in terms of rupees. When that happens, the bounty will disappear. In other words, there is a race between the specific depreciation of the rupee in terms of foreign currencies and its general depreciation in terms of commodities and services. Exports will be stimulated only so long as the specific depreciation is greater than the general depreciation. As regards National finance, the effect differs in different cases. The sterling obligation of the Government of India is really paid by the remittance of surplus *produce* from India, the magnitude of which depends upon the value for which the produce could be sold in the money obtained outside India. If the fall in exchange is due to a rise in the purchasing power of sterling, India will be obliged to send a large amount of produce than formerly to meet its sterling obligations; and Government will have to resort to increased taxation in some form or the other. Either there must be new taxes or the old taxes must be made to command more produce by an artificial enhancement of the value of the rupee; in either case, the final result is the same; there will be an increase of taxation of the people of India of an entirely unavoidable kind. If, on the other hand, sterling prices remain steady and the fall in exchange is due to depreciation in the purchasing power of the rupee, the same produce will be sent from India as before, though the Government may find that owing to the depreciation of its money, its revenue is insufficient to obtain command of the produce required to meet its sterling liabilities. In this case, what is lost by the Indian Government clearly amounts to a remission of taxation of equal amount to the people of India. The problem then is not how to increase taxation as compared with what it was before, but how to make the taxation *equivalent* to what it was before.

Similarly, if the rise in the rupee-sterling exchange is due to the depreciation of the purchasing power of sterling while the Indian rupee prices remain steady, India will part with *less* of her produce in discharge of its commitments abroad. On the other hand, if the Indian exchange rises because rupee prices fall while sterling prices remain the same, the *same* amount of produce will be sent as before in discharge of external obligations. But so long as the Government revenue in rupees remains the same, it will command *more* produce than is needed by Government for the discharge of its liabilities abroad. In that case Government gains at the expense of

the tax-payer who, while giving nominally the same amount of rupees as before, in reality parts with a greater purchasing power over goods.

But when once the amount of money realised from taxation has adjusted itself to the depreciation or appreciation of the internal monetary unit, Government will cease to lose or gain in the cases discussed above. For instance, when the tariff valuation of all the commodities paying Customs duties rises owing to the depreciation of the rupee, Government will realise more rupees from Customs. Similarly, rising prices will mean rising incomes and the taxes on income will yield more. When business and profits are good because of rising prices, there may be a larger movement of goods than before and the railway earnings may go up. And if commercial undertakings like the railways increase their charges because of increase of prices and wages, Government may gain rather than lose. Of course, in such a case taxes, which are fixed for any length of time, will not respond to the movements in prices. But at least so far as the Government of India is concerned, most of its sources of revenue are not of this sort.

COMMON ERRORS.

This brief statement of the theory easily disposes of some of the common errors in the ratio controversy. But for the effect on our protective tariff to which I shall refer separately, the country as a whole could not have lost anything by the mere change in the rate from 1s. 4d. to 1s. 6d. Certain sections of the community have gained temporarily at the expense of other classes; and among the classes that have gained, *the most important is undoubtedly the Government*, and this, I trust, Sir Basil Blackett will not forget easily. The *normal* rate of exchange depends upon relative price levels, and the facts of the period in question show that the rise in exchange to 1s. 6d. has been brought about partly by the rise in sterling prices between May and December 1924 and partly by a relatively greater fall in Indian prices between November 1924 and June 1925. To the extent that this rise in rupee-sterling exchange was brought about by the depreciation of the purchasing power of sterling between May 1924 (168)* and December 1924 (180),* India parted with *less* of her produce in discharge of its commitments abroad. The fall in sterling prices or the rise in the purchasing power of sterling between December 1924 (180)* and June 1925 (162)* forced India to part with a *larger* amount of produce than formerly to meet its sterling obligations; and had Indian prices

* Index Number.

remained the same, Government would have been forced to resort to increased taxation in some form or the other. Owing, however, to a fall of Indian prices from 180 in November 1924 to 157 in June—a fall much greater than the fall of English prices in the same period, Government was able to command by means of its rupee revenues from taxes *more* produce than was needed by it for the discharge of its liabilities abroad. To the extent that rupee prices fell *more* than English prices during this period, and it was partly this which sent the exchange up, Government gained at the cost of the tax-payer. But so far as the country as a whole is concerned, some loss is *inevitable in every fall* of sterling prices owing to our sterling obligations, and 1s. 4d. rate would not have saved us from this inevitable loss. To talk of India losing 45 crores a year by this rise in exchange is an obvious absurdity. If India could gain so much by a fall in exchange to 1s. 4d., why not continue merrily the process of depreciation till the rupee comes down to 10d?

THE CASE OF AGRICULTURISTS.

It has been repeated *ad nauseam* that agriculturists form 79 per cent of the population; and that this class has suffered heavily as sellers of produce, as taxpayers and as debtors by the rise in exchange, or what amounts to the same thing in this controversy, by a fall of prices. I shall not weary the audience by a detailed examination of this revised form of the old official apologia for the high prices in India; enough has been said in the press against the alleged beneficent influence of high prices. I shall content myself by inviting attention to the fact that Mr. Datta who talked of the beneficent influence of high prices in 1911, repudiated it in his evidence before the Babington Smith Committee, and by pointing out that the census of 1921 shows that agriculturists form 71 per cent. and not 79 per cent. of the population, and that it is an error to consider the agriculturist as forming a *single* class affected in the same way by a rise or fall in prices. There is the numerous class of farm servants and field labourers, estimated in the census of 1911 at over 41 millions and in that of 1921 at 38 millions who ordinarily stand to lose by a rise of prices and to gain by a fall of prices, except so far as their wages are payable in kind and not in money. There is the small cultivator who ordinarily has little surplus to sell and lives mainly on what he produces, and who, therefore, is unaffected by a rise or fall of prices. It is only the remaining few among agriculturists, having a *surplus for sale*, who can possibly gain by a rise of prices or lose by a fall. Even

this class secures by a fall of prices some compensation against the loss on sales; they pay less for at least *some* of the commodities they buy; they get their ornaments more cheaply; and what they save in rupees has more purchasing power. When allowance is made for all these factors, it will be plain that it is only a minority of the population that stands to gain by a rise of prices or lose by a fall. Statistical data for the whole of India are wanting; but if the investigations of Dr. Mann in two of the food-producing villages of the Deccan (and 78 per cent of the cultivated land in India grows food grains) are any guide, it cannot be doubted that on the whole the net effect of a rise of prices on rural prosperity is adverse and that of a fall of prices beneficial.

Turning to the changes in prices of agricultural produce since October 1924, one finds very little justification for raising any alarm even among the agriculturists who have a surplus for sale. An examination of Mr. Findlay Shirras' estimate of the total agricultural income of India for the year 1920-21 shows that food grains form 52.4 per cent of the total value, sugar only 5.1 per cent, cotton 1.9 per cent, and oil-seeds 4.5 per cent; and that out of total acreage of 238,933,187 devoted to agricultural crops, nearly 187 million acres grow food grains, less than three million acres grow sugar, 14 millions grow cotton and 26 millions grow oil-seeds. The Bombay index number of food grains has *risen* from 138 in November 1924 to 150 in September 1926, that of sugar has fallen from 187 to 156, oil seeds have dropped from 147 to 140 and cotton from 234 to 140. It is plain that the bulk of the agriculturists have *gained* rather than lost by changes in prices since October 1924. Nor is there any doubt that such a serious fall as has taken place in cotton could not have been due mainly to exchange.

As a tax-payer, the agriculturist whose land revenue was fixed during the period 1917-24 when prices were higher than the present level, has undoubtedly suffered by the fall in prices since the settlement of his land. But the fall in prices between 1918 and September 1924 would have been equally necessary in case of 1s. 4d rate; the 1s. 6d. rate is directly responsible only for that burden which is due to the excess of the fall in Indian prices over that in English prices during the period intervening between November 1924 and June 1925. But if questions of equity are relevant in matters of currency reform, it is *unfair* to take only this *limited period* into consideration. Between 1900 and 1918, prices were rising continuously; and the agriculturist whose land-revenue was fixed when prices were comparatively low gained during the

following period of higher prices. Even to-day, thousands of agriculturists whose land revenue was fixed before 1917 are better off than at the time of settlement. Men with fixed incomes and wage-earners, whose wages generally lag behind prices; have, on the other hand, been all along suffering since 1900. It must also be borne in mind that just as the country as a whole parted with *less* produce when sterling prices were soaring high, the country as a whole has to part with *more* of its produce now that sterling prices are falling in order to discharge its foreign liabilities; and in fairness this additional burden must fall on the *very* class that secured relief during rising prices.

Much the same thing has to be said regarding equity between creditors and debtors. If the debtor class has a prescriptive right to rising prices and the creditor class has only a prescriptive duty of allowing himself to be cheated, let us be frankly Bolsheviks. But apart from this, there is a serious error in Sir Purshotamdas' reasoning in Para 127 of his Minute. Increase in the burden of old debts is brought about not by a rise in *exchange* but by a *fall in prices*; and prices even today are higher than the level of 1900-17. Even if the bold assumption that the greater part of 800 crores of agriculturists' debt was contracted during 1900-17 be allowed to pass unchallenged, it cannot be doubted that the burden of this debt must have *decreased* by the rise of prices since 1900-17. In fine, equity points to the restoration of pre-war level of *prices*, and not the pre-war level of *exchange*; for injustice is due to the rise or fall of *prices* and not to the fall or rise in *exchange*. It is conceivable that exchange may rise or fall not because of any change in our price level, but because of changes in prices abroad; no question of equity can then arise between the different classes of our community.

The truth is, that the currency reformer has to keep aside all these nice considerations of equity. His role is a limited one; he must look only to the facts and tendencies of the present and the immediate future; he must consider only what is practicable with the least possible disturbance. Let me at this stage invite attention to the remarks of a disinterested expert, Prof. Gustav Cassel of Sweden, as to the sanctity of the 1s. 4d. rate. "The idea that the rupee must necessarily be restored to the pre-war gold parity of 1s. 4d. has," he says, "a striking resemblance to the programme of raising depreciated currencies to the pre-war parity, which has played such an unfortunate role in the recent monetary policy of many European countries. If no better reason can be given for choosing 1s. 4d. as the value at which the rupee should be stabilised, the idea ought to be abandoned, and the sooner the better."

IMMEDIATE STABILISATION AT 1s. 4d. MEANS INFLATION.

Let me now deal with some of the points raised in the dissenting note of Sir Purshotamdas Thakurdas. In para 67 of his Minute he contends that the Government of India had an *excellent opportunity of stabilising the rupee* at 1s. 4d. gold in the month of September 1924. The index number of prices in the United States stood then at 149 and of Bombay at 181, compared to the pre-war level of 100. In August 1926, the Bombay index number fell to 148; while that of the United States was again 149. If the contention of Sir Purshotamdas implies that the normal rate of exchange as determined by the relative price-levels was 1s. 4d. gold in September 1924, the Bombay index number should have been made to rise 33 points in order to bring down the normal rate of exchange once again to 1s. 4d. gold in August 1926. In other words, those that are pressing for stabilising the rupee at 1s. 4d. ratio are in reality asking for the rise of prices by nearly 22 per cent on the existing level. There is *no other way* in which Government can stabilise at 1s. 4d. ratio at the present moment.

Sir Victor Sassoon and Sir Purshotamdas have warmly repudiated the suggestion that the process by which such a rise of prices and the consequent fall in exchange can be brought about immediately is *inflation*. Mr. B.F. Madon has done even better. He accuses all those who dare to differ from him of not knowing the meaning of the word "inflation". Let me, therefore, invite the attention of the public to the following answer given by Dr. Edwin Cannan whose bonafides the Bombay economists in favour with the Currency League have never questioned and whom the Bombay school has always quoted in their own favour in the matter of the gold currency:—

Q 3301—What would be the effect if the rupee was stabilised at 1s. 4d.?—“I suppose you would have to *water the currency* in India in order to do it with the usual results.”

Dr. Gregory who was exactly of the same opinion, in answer to question 12669 said to the Commission, “If you were to insist on a lower rate of exchange, 1s. 4d., then there would be a preliminary *watering* down of the currency to maintain the rate at 1s. 4d.” If the weighty opinion of these English economists is to be discounted because of the suspicion that they have the interests of England in view, let me quote, the opinion of the eminent Swedish Economist, Prof. Gustav Cassel. “If on closer examination it is shown that the present purchasing power of the rupee lies in the neighbourhood of 1s. 6d., a

lowering of the value of the rupee from 1s. 6d. to 1s. 4d." he says, "means a process of *inflation* which is just as harmful as the deflation which in some European countries would be required in order to raise the value of the currency to a higher pre-war level." I trust Sir Victor Sassoon and Sir Purshotamdas Thakurdas will not deny these distinguished economists the credit of knowing what "watering down" and "inflation" of currency mean. The question, therefore, arises whether the country shall go in for this "watering down" of currency, the inevitable rise of prices, and its consequent hardship and injustice to a considerable section of the population, with a view to compensate those sections which may still continue to suffer owing to the maintenance of 1s. 6d. ratio. This is the real question which Sir Purshotamdas and Sir Victor Sassoon have to answer.

THE QUESTION OF ADJUSTMENT.

Throughout his Minute Sir Purshotamdas labours to point out that prices, wages and contracts have not adjusted themselves completely to the 1s. 6d. ratio. While subjecting this argument to a close scrutiny in his last lecture at this University, Sir Basil Blackett pointed out a serious arithmetical error in para 95 of the Dissenting Minute, asserting rightly that a rise of 27 per cent in exchange should be followed by a fall of 21 per cent only in prices. In a spirited rejoinder Sir Purshotamdas questions this assumption, and asks what it is based on. Let me take the liberty of pointing out to him that Sir Basil Blackett's assumption is based on the very same theory which he has himself applied, *viz*, that the rate of exchange depends on relative prices, varying directly as the world prices and inversely as the Indian prices. If exchange rises from 100 to 127, Indian prices must fall from 127 to 100, the world prices remaining the same. A fall of 27 on 127 makes 21 per cent, and not 27 per cent. In the particular example discussed in para 95 of the Minute, 100: 127:: 155/185: 155/p (the required Indian price level) which means that p is equal to $18500/127$ or 146 nearly. This amounts to a fall of 39 points and not 50 points, as is assumed by Sir Purshotamdas. If therefore the Index numbers used are any guide, Sir Purshotamdas greatly exaggerates the degree of non-adjustment of prices to 1s. 6d. in February 1926. But granting for the sake of argument that complete adjustment requires more time, has Sir Purshotamdas ever attempted to prove the period of time during which prices, wages and contracts were adjusted to the ratio of 1s. 4d. gold ever since 1917? A glance at the table on page 57 will show that

between October 1920 and to-day, it was only in September 1920 and between September and October 1924 that the rupee exchange was 1s. 4d. gold and that, therefore, *during full six years prices never had the time and the opportunity to get adjusted to 1s. 4d. gold.*

It is impossible for any one to contend with any show of reason that prices, wages and contracts, for the larger part, during the years 1917-1926 continued in adjustment to the pre-war ratio of 1s. 4d., and that all the violent oscillations of exchange since 1917 *had no effect* on prices, wages and contracts. Even if the non-adjustment of prices, wages and contracts to the 1s. 6d. rate be as great as Sir Purshotamdas imagines it to be, he has yet to prove that the adjustment to 1s. 4d. rate is *more complete*. If we are determined to stabilise the exchange *immediately*, we must choose the rate that will cause the least disturbance. From this point of view, the presumption surely is in favour of a rate that has continued for more than 18 months; and the burden lies heavily on those who advocate immediate stabilisation at 1s. 4d. to rebut this presumption and prove that it will cause *less* disturbance than 1s. 6d. rate.

HOW THE RATE OF 1s. 6d. WAS REACHED.

In paras 68 to 76 of his Minute, Sir Purshotamdas accuses Government of having manipulated a rise in exchange by deflation, and argues that "deflation, and a consequent raising of exchange has been accomplished by preventing the expansion of the currency to the extent *normally* required by India, as evidenced by the prewar annual average of expansion." The pre-war annual average expansion of currency in India was according to him over Rs 20 crores, while the average annual expansion during the years 1921-22 to 1924-25 was only 11.12 crores a year. There are a number of fallacies in this argument. In the first place, we must compare with the pre-war annual average expansion of currency, not the average for the four years 1921-22 to 1924-25, but the average for the *whole* of the *post-war period*. The table II on page 57 will show that the postwar average expansion was nearly 25 crores and not 11.12 crores, the total for the eleven years 1914-15 to 1924-25 being 270.39 crores. To take only four exceptional years out of eleven in the case of post-war period and fourteen years in the case of pre-war period is clearly a misuse of statistics. For a proper comparison we must take at least a decennial period in both cases.

This line of argument assumes further that (1) the average annual expansion of our currency under the pre-war system was a

correct measure of our currency needs under an *automatic* system and (2) that the normal average in a period of *rising* world prices is also the normal in a period of *falling* world prices. The first is obviously untrue if, as he himself agrees, "Under the Indian system contraction is not, and never has been, automatic." (para 16 Report). The very fact that under our pre-war currency system our prices rose higher than gold prices in other countries shows that our currency was expanded out of all proportion to the growth of our trade and business. The second assumption ignores the difference between our pre-war period and the period following 1920. During the five years ending 1913-14 our net exports amounted on an average to 78.36 crores while in 1920-21 the net exports amounted to -77.55 crores, in 1921-22 to -20.90 and in 1922-23 to 90.01 giving an average for the three years of only -2.81 crores. The first was a period of rising world prices; the second, one of falling prices. In para 82 Sir Purshotamdas himself admits as a historical fact that the prices rise during wars, and gradually fall after peace. It is obviously untenable to argue that currency under the Exchange Standard must be expanded at the *same rate whatever the balance of trade may be*, or that in a period of *falling* prices currency needs to be expanded, and that at a *rate* required in a period of *rising* prices. In 1920, gold prices in the United States fell from 233 in January to 179 in December. The year 1921 too was a year of falling prices in the United States, the index number coming down from 170 in January to 140 in December. In the months of June and July, the rupee had gone *below even 1s* gold and yet Government expanded our currency by two crores. The year 1922 was one of rising prices in the United States; the Indian Government wisely abstained from adding more than three crores with the result that exchange rose to 1s 2 27/32d gold in December 1922. Had Government added as much as 20 crores a year, the normal amount according to Sir Purshotamdas, the rupee would have depreciated considerably. At any rate, it does not lie in the mouth of an advocate of 1s. 4d. ratio to object to a *course that was absolutely necessary* in order to bring the rupee nearer to *1s. 4d. gold*. In 1923, prices fell in the United States from 156 in January to 151 in December; and no case really existed for expanding the currency. Yet the Government of India added as much as 22.5 crores *i. e.* more than Sir Purshotamdas' normal. Indian prices were steady during the year, and under the effect of relative price levels of the United States and India, there must have been a latent tendency to a *fall* in the normal rate of exchange; but, owing to temporary factors such as the balance of account,

exchange rose and would have risen higher but for the unjustifiable action of Government in expanding currency by as much as 22½ crores in a period of falling world prices. Upto 1923 then, Government had done nothing to deserve the indictment of their critics; if at all, they deserve *censure for having expanded currency at all* in such circumstances.

Between December 1923 and September 1924 prices in the United States and India remained pretty steady; there was thus no occasion for expanding the currency till September 1924. Exchange touched 1s. 4½ gold in October and reached 1s. 515/16d. gold in June 1925. If this rise in exchange was the result of Government manipulation or deflation of currency, we must look for it in the facts of the period between October 1924 and June 1925. But according to Sir Purshotamdas himself there was an *addition* of 16 crores during 1924-25 (para 68); we have therefore to fall back upon some other causes of this rise in exchange. World prices rose during this period, the index number of the United States being 149 in September 1924, 161 in March 1925, and 157 in June 1925; this accounts for a *part* of the rise. Indian prices *fell* from 180 in November 1924 to 157 in June 1925; that certainly is a sufficient explanation of the remaining part of the rise in exchange. But why did Indian prices fall, when currency was expanded by 16 crores? The probable explanation of this phenomenon lies partly in the fact that the volume of trade was abnormally large in this period, partly in the tendency of rupee prices to move in sympathy with sterling prices which came down from 180 in October 1924 to 162 in June 1925, partly in the habit of Indian officials in charge of currency to judge the needs of the situation more by the trend of sterling prices than by that of dollar prices. It is undoubtedly true that if the Indian Government had decided to *manipulate currency by expanding it* in order to prevent the exchange from rising above 1s. 4d. gold, they could have done so during this period. What the critics of Government policy in this matter can prove is, therefore, not so much the charge of having manipulated currency in order to *bring up the rate to 1s. 6d. gold* as that of *not* having manipulated currency to *bring down* the exchange to 1s. 4d. during these months.

A word may here be said on the curious use of the word, "manipulation" in this controversy. If currency is *contracted* even in a period of *falling* world prices, it is said to be "manipulation" by Government; if Government neither expands nor contracts currency but *only abstains from expanding it*, it is even then accused

of manipulation, Strangely enough, when Government *expands* currency, it is seldom accused of manipulation, though expansion involves *positive* action on the part of Government and depends *more* on the *will* of Government than contraction.

1s. 6d. AND THE TARIFF.

The examination of price movements in India and the United States leads to three interesting conclusions. If relative price levels were adjusted to 1s. 4d. ratio in pre-war days, the normal rate of exchange as determined by the purchasing power parity was 1s. 6d. gold and not 1s. 4d. gold. in June 1925. The index numbers of both the United States and India stood at 157 in that month compared to the level of 100 in the pre-war year; and exchange in that month was 1s. 5 15/16 gold. *The rise of the normal rate was due to the raising of the tariff since the war.* That this is the real cause of the rise in exchange is admitted by some of our official witnesses before the Currency Commission. In answer to Question No. 27, Sir Basil Blackett said, "Broadly speaking, the level of prices is now at about 160 as compared with 100 in pre-war days, British, American and Indian prices have come together at a figure about 160....I am not quite sure what value is really to be attached to any of those index numbers and particularly to the Indian one. It is hard to be sure that it is completely valid. At the same time it does suggest that prices have now come together, and if an explanation is wanted as to the reasons why the rupee at 1s. 6d. now instead 1s. 4d. before the war, the rise should be much the same in India as in other gold standard countries, I think the answer is that there has been a very *considerable development* in the Indian tariff which would naturally raise the Indian figure. With exchange at 1s. 4d. as it was in pre-war days, you should have expected Indian prices to be nearer 180." Mr. C. H. Kisch, the Finance Secretary of the Indian Office, admitted in this written statement that there seems to be no convincing reason for assuming that the ratio between Indian and United Kingdom prices will necessarily be the same in the future as before the war. The course of events has been different in the two countries and *allowance must be made for the heavy general tariff which is now in force in India.*" Does not all this amount to an admission that 1s. 6d. ratio has nullified the effect of the tariff, and that if the beneficent or the adverse effect of the tariff raised since the war has to be maintained, stabilisation of exchange must take place at a *rate that allows for a greater rise of prices in India than in the United Kingdom.* It is obvious that in bringing down relative prices to the *same level* in India, our currency

authorities have *entirely ignored the tariff*. This is the real disadvantage from 1s. 6d. rate; and to this criticism Sir Basil Blackett has never attempted an answer.*

DEFLATION SINCE AUGUST 1925.

The second conclusion to which a survey of price movements leads serves to show how exaggerated are the complaints made against the deflationary policy of Government since August 1925. It is not the high or low level of prices that matters, it is the *rising* or the *falling* prices that really inflict injuries upon particular sections of population. Suppose Government had stabilised the rupee at 1s. 4d. gold during the period of October 1924 to June 1925, would not the rupee prices have moved exactly in the same way as they have actually been doing since then? The index number of the United States which stood at 160 in August 1925, came down to 151 in August 1926 and to 149 in September 1926. The Bombay index number came down exactly to the same extent; it was 160 in August 1925, 148 in August 1926 and 149 in September 1926. Stabilisation in gold at *any* particular rate implies that rupee prices will continue to fall if gold prices fall. Any injury that might be caused by any contraction or deflation that may be needed in order to bring about adjustment between rupee prices and gold prices is *inevitable* under any automatic gold standard; it is a necessary price that every country which decides to restore or establish the Gold Standard must pay. The critics of Government who raise a hue and cry against the deflation that has taken place since August 1925 have to prove that this deflation would have been much less if the rupee had been stabilised at 1s 4d. gold during the period intervening October 1924 and June 1925.

WHAT WOULD HAVE BEEN THE WISER COURSE?

The only way in which the evil consequences of deflation could have been avoided by the country was to have postponed stabilisation of exchange to September 1926 when the world prices as measured by the United States index number again stood at the same level as in September 1924, *viz*, at 149. Had the Government of India attempted to maintain Indian prices at 179, the level of September 1924 throughout the two years ending September 1926,

* The only answer attempted by Basil Blackett in his presidential remarks on my lecture was that our tariff was mainly a revenue tariff. But it can not be denied that it would have had a protective effect but for the rise in exchange, particularly after the repeal of the cotton excise duty.

the normal rate of exchange as measured by relative price levels after making allowance for tariff changes would have been 1s 4d. gold in September 1926.

But this course would have produced *instability of exchange* throughout the period of these two years. In other words, we would have gained stability of prices and lost the stability of exchange. There is much to be said for the view that the gain would have been greater than the loss. I, for one, am convinced that this would have been the better course. But this is not the case of the critics of Government. Sir Purshotamdas continues to talk of the opportunity of October 1924 for *stabilising* exchange at 1s. 4d. gold. Stabilisation at *that* rate at *that* time would in all probability have necessitated greater deflation than has been actually the case since August 1925.

THE COURSE OPEN EVEN NOW.

If, however, Sir Purshotamdas now agrees with me that this would have been the right course, fortunately for India that course is open even now. The world prices have been *falling*; and most of the currency experts of the world are agreed that we are in for an era of *falling prices* for some years to come. Let the Legislative Assembly insist on the maintenance of the present price level in India till *falling* world prices bring relative prices in India and the gold standard countries like the United States to the same position as existed in September 1924. This will mean instability of exchange for probably more than two years, for the *rate* of fall of world prices may *slow* down. In other words, we have to sacrifice stability of exchange and content ourselves with price stability for some time to come. But let the unwise talk of *immediately* stabilising exchange at 1s. 4d. gold by *expanding* or watering the currency *cease*. It is too late in the day to catch votes of even the agriculturist by the slogan "rising prices are good for the country." Government played that part when the late Mr. Gokhale attributed the rise of prices to the currency policy of Government. Government have given up the position, thanks to the efforts of Indian critics. Let not the Currency League and the Legislative Assembly revive this dangerous doctrine and earn the ill-will of all classes who will suffer hardship on account of dear bread and higher cost of living. Let them take their stand, instead, on *stability* of prices till the 1s. 4d. rate is reached automatically under the influence of *falling* world prices and spare the country the evil effects of *immediate* inflation and subsequent *deflation* involved

in a policy of immediate stabilisation at 1s. 4d. The Currency League will then have within a comparatively short period of time both the pre-war 1s. 4d. rate and the post war tariff wall.

THE THIRD CONCLUSION.

A third inference is no less irresistible. Since the fall of rupee prices since August 1925 is of the *same* extent as the fall in dollar prices, it follows that so far as the commodities included in the Bombay index number go, the adjustment to 1s. 6d. ratio was complete before August 1925, and that the disturbance and injury to certain classes caused by 1s. 6d. rate since August 1925 has been *no greater* than what have taken place even under the 1s. 4d rate. Similarly, the disturbance and injury caused by the rise of exchange from January 1921 when the rate fell down to 1s. 0 15/32d. gold to September 1924 when exchange reached 1s. 4½d. gold would have occurred in *any* case, whether the final rate for stabilisation had been 1s. 4d. or 1s. 6d. Apart from what has been said above regarding the nullifying effect of exchange on tariff, the only disturbance peculiar to 1s. 6d. rate is the effect of the rise in exchange between October 1924 and June 1925. So far as this rise was due to the rise of world prices (United States), it could have had no disturbing effect on prices and wages in India, So far as it was result of falling prices in India, it must certainly have inflicted unmerited injury on certain classes. But it had no disturbing effect on the bulk of India's foreign trade which is conducted on the basis of sterling, for the rupee-sterling exchange was in the neighbourhood of 1s. 6d. throughout this period. Against the loss inflicted on certain sections by this rise, we must set off the gain to certain classes from the stability of the rupee-sterling exchange and the compensating effect of a rise in world prices. It is plain that the disturbance and the injustice caused by this rise is greatly exaggerated in the popular discussions on the subject.

CONCLUDING REMARKS.

I hope I have now made it abundantly clear that there are serious objections to stabilising our exchange at the present moment. To stabilise at 1s. 4d. is to raise prices and so inflict unmerited injury on certain classes; to stabilise at 1s. 6d. is to nullify the protective effect of our tariff. We must avoid both; and the only way to do so is to maintain stability of prices for some time, allowing exchange to fall down to 1s. 4d. under the influence of falling world prices.

TABLE I
Rate of Exchange From Calcutta on London on the 1st of every month
(Gold Rate.)

—	1920.	1921.	1922.	1923.	1924.	1925.	1926.
	s. d. gld.	s. d. gld.	s. d. gld.	s. d. gld.	s. d. gld.	s. d. gld.	s. d. gld.
Jan .	1 10	1 0 15/32	1 1 25/32	1 3 9/32	1 3 1/16	1 5 21/32	1 6 3/16
Feb .	1 11 7/32	1 1 1/8	1 1 23/32	1 3 5/8	1 3 5/16	1 5 11/16	1 6 7/32
Mar .	1 9 3/32	1 0 3/8	1 1 27/32	1 3 5/8	1 2 9/16	1 5 17/32	1 6 11/64
April.	1 10 1/4	1 0 9/16	1 1 21/32	1 3 13/32	1 2 23/32	1 5 17/32	1 5 59/64
May .	1 9 7/16	1 0 23/32	1 1 25/32	1 3 7/16	1 3	1 5 23/32	1 5 61/64
June .	1 8 3/8	1 0 1/4	1 2 3/8	1 3 5/16	1 2 15/16	1 5 15/16	1 5 15/10
July .	1 4 7/8	0 11 23/32	1 2 3/16	1 3 1/8	1 3 1/8	1 6 1/16	1 5 59/64
Aug .	1 5 5/16	0 11 9/32	1 2 5/16	1 3 1/16	1 3 13/16	1 6 1/16	1 5 31/32
Sep .	1 4 5/16	1 0 13/16	1 2 7/32	1 3	1 3 7/8	1 6 3/32	1 6
Oct .	1 3 17/32	1 1 3/8	1 2 7/32	1 3 3/32	1 4 1/4	1 6 1/16	1 5 61/64
Nov .	1 1 11/16	1 1 5/16	1 2 11/32	1 3 3/8	1 4 13/16	1 6 1/16	1 5 27/32
Dec .	1 1 3/16	1 1 5/32	1 2 27/32	1 3 3/8	1 5 3/16	1 6 3/16	1 5 3/4

TABLE II
(In lakhs of rupees.)

Years.	Rupees.	Notes active circulation.	Total.	Sovereigns and half Sovereigns. £1-Rs. 15	Grand Total.
1914-15 ...	6.70	6.01	12.71	8.43	4.28
1915-16 ...	10.40	9.23	19.63	29	19.92
1916-17 ...	33.81	13.89	47.70	3.18	50.88
1917-18 ...	27.86	17.22	45.08	14.25	59.34
1918-19 ...	45.02	49.29	94.31	5.81	100.12
1919-20 ...	20.09	20.20	40.29	3.32	36.97
1920-21 ...	25.68	5.90	31.58	4.38	35.96
1921-22 ...	10.46	9.35	1.11	2.78	1.67
1922-23 ...	9.56	3.87	5.69	9.43	3.74
1923-24 ...	7.62	7.96	15.58	6.74	22.32
1924-25 ...	3.65	2.51	1.14	14.53	15.67
Total for 11 years ...	96.05	116.59	212.64	57.55	270.39

The Currency Issue.

What it is and What (4)
it Means.

*Reprinted with Additions from
the "Statesman."*

With summary of the Royal Commission's Recommendations,
a Speech by Sir Basil Blackett, and a note on the recent
condition of the Money Market.

1927
CALCUTTA.

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CHAPTER I.

THE PROBLEMS OF THE COMMISSION.

The Royal Commission on Indian Currency and Finance presented its report in August, 1926, and as a result a Currency Bill of great importance to India may come before the Assembly in Delhi early in 1927.¹

For many the subject has a passionate interest and the rupee touches us all in that most vital part of our persons, the pocket. Yet the mystery of the exchanges is apt to baffle the average man. Though he would dearly love to know what exchange is going to do, he supposes that some special convolution of the brain-pan is required before one can hope to grasp why the rupee should sometimes behave like a grasshopper, while at others it remains as unmoving as the Sphinx. But the main point is simple enough and if he will only keep his eye on it, it is possible for the "man in the street" to arrive without tears at an adequate understanding of the arguments of the experts. Clearly the subject concerns the plain man's salvation.

These chapters are written in the hope that to some extent the writer may be able to act as an honest broker between the technical experts on the one hand and the lay but interested public on the other, so that the controversy already raging may not be conducted above all our heads.

First of all let us note the points on which the Currency Commission had to pronounce a judgment.

¹The members of the Royal Commission were the Rt. Hon. E. Hilton Young, D.S.O., (Chairman), Sir R. N. Mookerjee, K.C.I.E., Sir Norcot Warren, K.C.I.E., Sir Reginald Mant, K.C.I.E., C.S.I., Sir Maneckji Dadabhoy, K.C.I.E., Sir Henry Strakosch, K.B.E., Sir Alexander Murray, C.B.E., Sir Purshotamdas Thakurdas, C.I.E., M.L.A., Professor Coyajee, Mr. W. F. Preston.

It had to decide whether India should have once more, as in the days before the War, a stable rupee bearing a fixed ratio to other stable currencies, or whether she shall continue to have, as at present, a rupee which fluctuates in relation to other currencies but is so "managed"—through the issuing and buying and selling operations of Government—as to keep the level of prices in India itself as stable as possible.

If we are to have a stable rupee, in terms of what is it to be stabilized? Before the War the rupee was linked with sterling and its value was one and fourpence in English sterling money, which everybody regarded as one-fifteenth of a golden sovereign. But during the war there arose a wide cleavage between sterling and gold, so that there were times when the one pound treasury note was worth far less than a golden sovereign. Sterling has linked up again with gold, but we have been taught that they are by no means so indissoluble as had been supposed, and the Commission had to decide to which of the two India's currency shall be anchored.

It has unanimously reported in favour of stabilization in terms of gold, and with one dissentient who prefers 1s. 4d., in favour of fixing the value of the rupee at 1s. 6d. gold, or more accurately, at one-thirteen-and-a third of a golden sovereign.

Then again, is this stability to relate to external prices and to our dealings abroad only, while in India itself we are to continue to have no other standard but the rupee itself? That was how matters stood before the war when we had what is called the Sterling Exchange standard. We could now have either a sterling or a gold exchange standard. But the Commission was pressed to go further than this by many witnesses

—amongst them Sir Basil Blackett himself— and to decide that India shall have its internal currency stabilized also in terms of gold. In this decision must be included the question of the silver market, for though now when silver is cheap the credit of the government maintains the rupee well above its intrinsic value, sensationally high silver prices such as ruled at the end of the war would naturally put up the price of the rupee.

Another question of the utmost importance the Commission had to consider in relation to this internal gold standard. Is India to attempt to have what most European countries had before the war, namely, what is called a convertible currency, in which gold coins actually circulate amongst the public and can be demanded in exchange for notes? Or should she conform to the post-war example set by Great Britain, Germany, Austria, Russia, Czecho-Slovakia, and other countries which, in some cases after much tribulation, have succeeded in stabilizing their currencies? Gold does not circulate as currency in these countries, but the currency is based on a gold bullion standard, that is to say the Bank of Issue or the State is bound both to buy and to sell gold bullion at a fixed rate of local currency to any customer offering more than a certain minimum amount.

The Commission has unanimously recommended a gold bullion standard.

The next question to be decided related to the controlling and issuing authority. Should this continue to be the Government of India and the India Office, or should the Imperial Bank become a Central Bank of Issue, or finally would it be necessary to create an entirely new Reserve Bank?

The Commission has, with one dissentient decided that it is necessary to create a new Reserve Bank.

Lastly the Commission had to consider what should be the value of the stable rupee in terms of gold.

With one dissentient, who prefers 1s. 4d. it has reported in favour of fixing the rupee at 1s. 6d. gold, or more accurately speaking, at one thirteen-and-a-third of a golden sovereign.

These are the problems and the recommended solutions. But before we try to understand what is meant by the stabilization of the rupee and what are the advantages to India of a high or low rate of exchange let us clarify our ideas about money. We shall approach the subject better if we first dismiss from our minds our ordinary conception of money as something which has an independent existence. We can only hope to understand the essentially simple principles of exchange and currency when we realise that money itself is nothing; that the only things we can get for ourselves in this world are goods and services of other people; and that the only things we have to give in exchange for them are our own goods and services. Money represents a call upon goods and services.

CHAPTER II.

WHAT IS MONEY ?

To get a clear idea about wealth as apart from money, we should put away from our minds for a time all thought of coins and bits of paper. For wealth consists solely in the goods and services that we can command.

If we have inherited wealth that means that an ancestor died without exhausting the store of goods and services to which he had established a claim. He must either have rendered sufficient service to the community and provided it with sufficient goods to receive from it the right to draw on its goods and services up to a certain amount, or must somehow have obtained legal sanction for this by creating the appearance of having earned them. Goods and services are of all sorts. Men have got wealth by fighting and receiving as reward a grant of land, or by being well educated and using their education to give service to their fellows. They have also got wealth by pleasantly flattering and soothing their maiden aunts in old age. It is not for us to judge the value either of our own services or of the goods we produce. That value depends entirely on the strength of other people's desire to possess them. If other people need either our society or our products enough they will give a good deal in exchange. If they do not need them, then however high our own opinion of ourselves, our talents, and our output we shall not be able to command other people's goods and services in return for them. That by the way seems to be why people who try to improve other people instead of improving themselves are nearly always poor, and deservedly so. They are not offering to the public the goods and services which it wants. Why should a boot-

maker in Northampton, a tailor in London, a wine-grower in France, and a house-owner somewhere else put goods at the disposal of a man who is engaged all the time in lecturing them when he should be improving himself and his own product ?

Now if we turn to the trade between all the citizens of one country and all the citizens of another we find that this is simply an exchange of goods and services. In fact the real nature of the transaction can be more clearly seen in the case of purchases abroad than when we buy goods for cash across the counter in our own country. For in the latter case money passes. We pay the shopman, say, a hundred rupees, and this money transaction tends to hide from us the fact that we have exchanged for the shopman's goods certain goods or services which we have previously rendered some other member of the community. Legally we were paid for those goods or services when we received the hundred rupee note. Actually we only receive payment when we part with the rupees to the shopman, and get from him a pair of boots. It sounds a paradox, but is perfectly true, that it is only when we spend money that we become rich. For money in itself is a perfectly useless and worthless possession except to a miser. For him it has an actual value of its own. The contemplation of it gives him pleasure and satisfies desire; therefore, for him it is "the goods" and renders service. However, to the rest of us this seems the symptom of a mind diseased.

But when we buy articles abroad, ordinarily no money passes between India and Europe at all. No rupees cross the water to London, nor does London have to pay its Indian creditors either in sovereigns or in fivepound-notes. The ships carry goods, and the bills for goods, between India and Europe, but they do not carry "money" for the

goods. The bills are sorted out by the brokers and in the end cancel each other. In other words the goods imported pay for the goods exported and vice versa. A., in Scotland, has to pay B., in Calcutta, for a shipment of jute. He asks his banker to provide him with the means of doing so. The Home banker has no rupees, but on the other hand through the machinery of commerce he is aware of the existence of C. who lives in Coventry but has been shipping motorcars for sale in Calcutta. His agent has sold the cars, and C. therefore possesses rupees in Calcutta which he is anxious to turn into sterling at Home. There is also D. who has shares in a Bengal coal company and has just been credited with a dividend in the form of rupees in a Calcutta bank, which he desires to convert into pounds in his English bank. So A.'s banker transfers a certain amount of A.'s sterling credit in his books to the credit of C. and D. in their banker's books, and obtains in exchange, on B.'s behalf the right of disposing of their rupees in Calcutta, which are thereupon transferred to the credit of B.—the Calcutta firm which shipped the jute on order to A. Thus we see that no money has crossed the water at all. The English motor cars and the English credit originally exported to Bengal in the shape of plant or personnel for the coal company have been exchanged against the Bengal jute.

The important point in this transaction is obviously the rate of exchange. How many of C.'s and D.'s rupees in Calcutta did A. get for each of his pounds in England?

CHAPTER III.

SETTLING THE RATE.

In the last chapter we took an instance where the rupees paid in Calcutta for C's Coventry-made motor cars are used by A who is in Scotland to pay B for jute shipped to Scotland. Now if nobody in England had a rupee credit in India except C, who had sold motor cars there, and D who had just had a dividend in a Bengal coal company, clearly A might have to pay a fancy price in pounds in order to obtain their rupees. The rupee would be high and the pound would be low. What actually happens however is that the total volume of business done in the exchange market settles the rate. A's banker has the benefit not merely of C's and D's desire to dispose of rupees, but also of the desire of a great many other people; and similarly there are many besides A in Great Britain who are offering pounds at home in exchange for rupees in India. The same thing is happening here in India. Here too there will be some who have claims to English money because they have sent goods to England and sold them there, or rendered services to residents in England, or are receiving interest on capital invested in England. These claims on English money they will wish to exchange for rupees here, and they will buy the rupees either from those who need English money to pay for goods ordered in England, or from the Government which has to pay pensions or other charges in England, or from those who wish to invest their savings in England.

The relation between supply and demand settles the rate of the day. If in England and India together the people possessed of rupees, or claims to rupees, are compelled to meet a larger

collective total of liabilities in pounds than the possessors of pounds have to meet in rupees, then the exchange goes against India in proportion to the discrepancy; from one-and-six it may fall to one-and five.

All, you see, depends on the volume of goods and services passing each way. If, on the balance of trade, we send England more than she sends us she falls temporarily into our debt, and the moment she tries to pay the difference the demand for rupees exceeds the demand for pounds, so up goes the value of the rupee.

How, then, we may well ask, is it possible to stabilize the rate at all?

Well, it can be done; but, in order to understand how, we must first realize that though the answer we have already given as to what settles the rate of exchange is correct and complete it is very superficial. We have next to ask what governs the balance of trade, and we find that this is determined by the relative price in the money of the two countries of the things which constitute their trade. In short the internal price level vitally affects exchange.

We can see this most simply by omitting, for the sake of illustration, the cost of transport and supposing that a quarter of wheat is worth sixty shillings in England whereas the price of the same quantity in India is forty rupees. In that case exchange would tend to settle round one and sixpence per rupee, or forty rupees for sixty shillings. For if exchange were at one-and-three, for example, people would buy wheat for forty rupees in India, sell it for sixty shillings in England, and then exchange the sixty shillings for forty-five rupees, thus making a profit of five rupees—if we neglect, as was postulated, the cost of transport. So many shrewd people will do this and will consequently have pounds to sell for

rupees that inevitably they will force down the value of the pound. Thus the exchange will rapidly swing upwards towards one-and-six, and this proves that the rate of exchange is a measure of the relative internal purchasing power of the currencies of the two countries in the particular goods in which there is trade between them. If cost of transport becomes abnormal this of course produces abnormality in the exchange. The price level in one country might be far below that in another country, yet the cost of transport might still make it unprofitable to export from the former.

It is clear, then, that unless exchange between two countries can in some way be fixed, it is the level of internal prices in the two countries which controls its fluctuations. On the other hand if you can fix your pound and your rupees in terms of a single commodity, say gold, the converse becomes true, and your internal prices will begin to fluctuate in direct relation to external prices in that commodity. To take the same example as before, and again for simplicity to ignore the cost of transport:—If wheat were sixty shillings in Europe and forty rupees in India, and the rupee had a fixed gold value of one-and-three so that forty rupees could only equal fifty shillings, and there was no means of pushing them up to sixty, then the demand for wheat for export, unchecked by any rise in the rupee exchange, would be so great as quickly to put the Indian price above forty rupees, while the stocks reaching Europe from India would bring the European price down below sixty shillings. Thus a rupee, the exchange value of which fluctuates in sympathy with price fluctuations abroad, is perfectly consonant with a steady internal price level in India; and when the foreign fluctuations are violent the elasticity of the rupee is a steadying factor in internal prices.

In the unexampled period of the last seven years, when world prices have been chaotic and the currencies of Europe in disorder, it has certainly been of immense advantage to India to have had her wagon hitched to no one else's star. She herself has been one of the stablest financial elements in a world of unrest, since the disastrously premature experiment of trying to fix the rupee was abandoned. But now the world is settling down, and the chances of general stability in its currencies are high. Even the mark and the rouble are once more at rest. For India now, therefore, the advantage is unquestionably on the side of stabilization of the rupee.

CHAPTER IV.

THE QUESTION OF THE STANDARD.

We saw that the balance of trade settles the rate of exchange, and since no one can foresee the balance of trade we have to ask ourselves how it can be possible to fix the rate of exchange.

The answer is that it is possible for different countries to have a common standard of value. They can select an article which enters into the commerce of all countries and state the value of all other commodities in terms of that. Since this article will thereupon be in demand everywhere not merely for its natural use but for purposes of currency, and as a token which can be exchanged at will for goods and services, it will practically have a flat rate throughout the world. If the mines greatly increase the output of gold as compared with the output of the world's goods and services, then the price of gold in terms of other commodities will fall in all countries, in other words, prices in general will rise and the purchasing power of gold will be less.

Under such a system the issuing authority keeps a reserve of gold sufficient to enable it to guarantee that anyone who demands gold in exchange for paper or base metal currency can have it. A shilling is guaranteed to be the twentieth part not merely of a "Bradbury" but of a golden sovereign, which in turn is guaranteed to be a certain proportion of an ounce of gold of a certain weight and a certain fineness. If a rupee is similarly guaranteed to be, let us say, one-thirteen-and-a-third of a golden sovereign, that is 8.4751 grains of gold, it follows that no matter how much the balance of trade may be adverse to one country or the other the exchange value of the rupee cannot be violently affected. It will still be

governed by the balance of trade, but it can only swing on either side to what is called gold point. That is to say, when the balance of her trade with India has turned against England to such an extent as to produce a fall in the pound, before this fall has become more than fractional it will pay her to ship actual gold to India, and there convert it into rupees at full rate and liquidate her debts. India, if the balance of trade should go against her, would adopt the same course. The limit of variation on either side of the rupee-pound standard exchange would be the cost of exporting a sovereign to or from India. The quantity of gold in a country would naturally react upon the price of commodities, but the foreign exchange would remain steady.

It is perfectly possible for a Government, where a silver or paper currency backed by its own credit has the confidence of the public, to do without a gold standard for all internal transactions, while maintaining a gold reserve simply for the purpose of stabilizing the foreign exchanges and settling any adverse balance of foreign trade. Or instead of buying gold, it might maintain a reserve of the standard money of any country with which it had extensive dealings, and, by selling this at a fixed rate to its own nationals when they required it, prevent fluctuations in the exchange.

This last is in fact what India did before the War. From 1898 to 1914, she maintained a sterling exchange standard. In those days the pound sterling was just as good as the gold sovereign, so that by guaranteeing to pay all her foreign trade or other obligations at a fixed rate of sterling exchange India kept the rupee steady in the exchange with all countries with a gold standard. And as she kept her sterling reserve in London—having indeed no use for it in India—

there did not even arise at any time the question of having to export it. The system worked very satisfactorily, yet in the light of post-war experience we now see that it was by no means secure. For there was absolutely no statutory obligation on the Government either to give gold for export at the gold export point corresponding to one-and-four (the pre-war fixed rate), or to sell sterling in London at a minimum rate of exchange corresponding to the gold export point. It is true that there was a statutory provision enabling anyone to present gold at the Indian mints in exchange for rupees at par, which prevented exchange rising above the gold import point, and moreover sovereigns were legal tender at 15 rupees to the pound. But though in practice the Government of India and the India Office prevented exchange from falling below gold export point by offering, whenever required, sterling drafts payable by the India Council in London (Reverse Councils) for tender in India, they were not legally bound to do so.

CHAPTER V.

THE RETURN TO GOLD.

The break-down of the sterling exchange standard during the War, and the discovery that there were circumstances which could produce a gap between sterling and gold, rule out the possibility of return to it. No one would be content with it, and if we are to be told that our rate is to be firmly fixed, the minimum which would give us any guarantee of this would be a gold exchange standard instead of the pre-war sterling standard. Instead of the pre-war obligation to maintain a ratio of so many rupees to the pound sterling, there will have to be an obligation to maintain a ratio of so many rupees to the gold sovereign. Moreover, as was said in the last chapter, there was a serious hole in the pre-war system because there was no statutory obligation on the authorities to sell sterling or other gold currency freely on demand, and thereby prevent exchange from falling below the gold export point. For absolute security the issuing authority will in future have to accept a double obligation, to buy and sell gold as required, and thereby to prevent fluctuations beyond the gold import and export points. This, it may be said, is a heavy obligation to take. It is; but not to take it would be less than honest if the authority asks for the complete confidence of the public. The knowledge of the statutory obligation should insure the maintenance of adequate reserves in gold and gold securities, such as bills of exchange on countries like England and America where currency is on a gold basis.

It will moreover ensure a wise management of the discount rate of India. To explain how that enables the authority to fulfil its obligation to keep

the rupee at gold parity it is necessary to glance at what is known as the quantity theory of money, which Europe's experience during the last ten years has put beyond the reach of serious challenge. The exchange value of any commodity, whether goods or services, clearly depends upon the amount of those particular goods or services offered in the market in question at a particular moment in relation to the demand for them. Fieldglasses, for instance, which were at a premium during the War, became a drug in the market the day the armistice was signed. Money itself is a commodity which obeys this same law. When there is too much money offering in the market its exchange value in terms of goods and services falls. In other words prices rise and purchasing power is diminished. Industry, we know, lives upon issues of credit, therefore a rise in the bank rate of India means that money becomes tighter in the market and its value in terms of other commodities tends to rise, which is the same as saying that the level of prices tends to fall. Clearly, then, a slight rise in the bank rate, by increasing the purchasing power of the rupee, tends to check a fall in the exchange value of the rupee towards gold export point. Restriction of credit facilities increases its value for all purposes, including purposes of exchange against the goods and services of foreign countries. Similarly a fall in the bank rate by making money more plentiful puts prices up, and tends to counteract a fluctuation of the rupee towards gold import point.

There can be little doubt that a gold exchange standard thus secured would in practice require a minimum of "management" and in general would work as automatically as, say, the currency of Great Britain. Most of the objections formerly urged against the sterling exchange standard could be removed on inaugurating the gold

exchange standard by amalgamating the gold standard reserve (that is the reserve maintained for exchange purposes) and the paper currency reserve (that is the reserve maintained as a guarantee for the value of the currency circulating in India), and entrusting control of currency to a central bank.

The Commission, though recommending these changes, has however rejected the gold exchange standard.

There are some minor remaining objections to the gold exchange standard. It is an odd and awkward system of currency which provides us with rupee notes the backing for which consists of over-valued silver rupees, which are themselves but token coins and therefore really notes printed on silver. To ensure fulfilment of the Government's promise to pay silver rupees on demand to all holders of paper currency, a large reserve has to be locked up in silver bullion. Compared with paper this is a grossly expensive material for the issue of notes, yet the Government is debarred from using it freely for conversion into foreign money when there is a surplus of currency in India. Moreover the gold exchange standard has no more chance of ever being understood by the country at large than had the sterling exchange standard before the War. There is a strong sentimental demand for a fuller gold standard, which will provide a gold backing for the rupee in India itself. These considerations doubtless weighed with the Commission.

CHAPTER VI

A GOLD CURRENCY STANDARD.

A good deal of the evidence put before the Commission favoured the opening of the Indian Mints to the free coinage of gold, and the issue of a gold coin into which all other forms of Indian currency should be freely convertible. The silver rupee does not contain either eighteen or sixteen pence worth of silver, and those who favour a gold currency therefore argue that there should be a metallic coin of full intrinsic value into which common money should be convertible.

Is it practicable to effect this vast change of system in India without risking immense disaster, the world being as it is to-day? Other countries which in the War period were forced to depart from the gold standard and have since succeeded in returning to it have dispensed with the luxury of a gold coinage in ordinary circulation. We may begin by suspecting that there must be good reason for that, and by doubting whether India, which did not possess this convertible gold currency before the War, would be likely to prove wise in adopting it just when the rest of the world seems to be permanently discarding it.

For India there are two tremendous considerations of expense to be faced at once. She would make an unprecedented demand upon the world for gold, and she would throw upon it an unprecedented quantity of silver which she herself has systematically over-valued.

The amount of gold she would require would be so vast as to imperil the stability of the gold standard (not a gold currency standard either) in other countries, and probably produce a serious drop in commodity prices all over the world. For the demand for gold would be suddenly far in

excess of the normal supply, and therefore its value in terms of goods and services would be greatly increased. Such a fall in world prices would be peculiarly disastrous to India which lives by the disposal of her various crops to a manufacturing and tea-drinking world. Moreover India's existing combined reserves for gold exchange and paper currency would probably prove unequal at the beginning to paying for all the gold needed. She would have to seek special credits in London and New York, and these credits would certainly not be forthcoming if there was any risk of dangerously depleting the world's stock of gold and upsetting prices in the world's markets. Before the authorities declared for a gold currency system they would have to be certain beyond any peradventure of their ability to see it through. Any underestimate of the amount of gold required would be absolutely fatal, and therefore in practice they would probably be compelled for safety to over-estimate. And although the existing reserves might in the end prove sufficient these assets could only be indicated slowly, for the rupees would have to be melted down and sold. It would be essential therefore to begin by securing the good-will of America and the promise of a loan if required.

The gold difficulty might therefore with sufficient precaution be got over. Far more serious is the silver difficulty. To throw upon the world's markets a vast unknown quantity of silver, which might quite possibly equal the normal output of all the silver mines for two or three years, would inevitably bring the price of silver rattling down to record depth. Not only would this depreciate all the silver hoards in India, and involve the Government itself in heavy loss, but it is certain that the scheme would encounter the implacable opposition of the silver-producing countries of

the world. In the forefront of this battle would be America which holds the whip hand in gold.

A root difficulty is that no one could say how many of our over-valued rupees would have to be melted and sold as bullion, and here again the authorities would be compelled to calculate on the possible maximum rather than on the probable maximum. The silver interests in America would certainly insist on knowing the full extent of the possible threat to the silver market before the United States would agree to assist India to establish a gold currency. The Government of India has coined about 650 crores in all of the present standard rupee, of which a total of 150 crores has from time to time been melted down by the mints. A great many have also certainly been privately melted down, but there are no means of knowing this figure. The maximum figure of silver rupees in existence could hardly safely be put at less than 350 crores. Again, no one knows, the minimum required for ordinary circulation but it cannot be less than 150 crores. This leaves a possible maximum surplus of 200 crores which would have to be withdrawn. Of these nearly half are already stored in the currency reserves, having proved surplus to circulation requirements. This leaves a little over one hundred crores of rupees stored in private hoards and reserves in India, Mesopotamia, East Africa, etc. This estimate may be too high but those responsible for introducing the scheme dare not assume so, and would have to face the possibility of dealing with the maximum. To melt down and sell 200 crores of rupees would mean to put upon the market some 700 million ounces of fine silver, and it may be said for certain that the necessary co-operation of the rest of the world could never be obtained for such a contingency.

The gold currency standard is therefore not

possible. In addition to this, however, it is out of date, and it is possible for India to obtain most of its advantages without its drawbacks by adopting neither the gold currency nor the gold exchange standard, but the gold bullion standard, which is what the Commission has recommended.

CHAPTER VII.

GOLD IN DECAY.

The theorists who oppose the gold standard are never likely to drive it out by the force of their intellectual demonstrations in a frontal attack. Yet it seems that gold, which served the world so well in the long climb from barbarism to civilisation, is being slowly driven from the field by the spread of that very civilisation it helped to create, and by the growth of international commerce under settled governments. The War was a tremendous education, for gold suddenly disappeared everywhere from currency without credit collapsing. Consider the enormous significance of the fact that when the whole world was straining every nerve to save itself, the last thing that anybody wanted was gold. Governments, busy with more important matters, were not willing to waste a penny on the useless stuff. To foist it upon neutral countries, and get in exchange much more useful food and munitions, was their principal aim, and consequently, to the confusion of the old-fashioned gold gossamer, the value of gold tumbled heavily in the War years. Had it been of much use it would have kept pace with the general rise in commodity values in terms of standard money, but such humble things as coal, cotton, and corn hopelessly outdistanced it, and it was not till 1920 that it began to raise its head again. But meantime we had learnt the lesson of making a little gold go a long way and in particular we had seen that amongst an educated community gold coins in circulation are a sheer waste. In the pre-war world the demand for gold for currency had maintained it at a fictitious price. Once you have stopped your teeth with it and gone in for a little gilt about the house its commodity value, with so many mines in existence, is trifling.

Obviously therefore, when there is serious work afoot in the exchange of goods and services, anybody who is left in with the gold gets the worst of the deal. In the War Europe dumped its gold on America in return for something really worth having, and had America not since succeeded in persuading us all to go back to a modified gold standard she would have had a sorry bargain.

But the gold standard was saved by the reckless printing-presses of Moscow, Berlin and Paris. Some standard of value is indispensable and more than half Europe was attempting to do without one, so in despair of quickly finding some more scientific solution men turned back to gold. But not to a convertible gold currency. That the Genoa Conference condemned as a waste and a useless expense; all that is required to give the necessary confidence and stability being the knowledge that a local currency can on demand be exchanged for gold bullion. So the gold coin has probably made its final exit from the world's market-places except as a curiosity.

The next step may be a further economy in the use of gold; for there are indications that international monetary authorities are working their way to something like the plan proposed by Professor Irving Fisher before the War. The gold bullion standard, which the former gold currency countries of the world have adopted since the War, means that a country's whole currency consists of token money (paper and base coin), but the Government or Bank of Issue is bound always to give on demand gold bullion in exchange for money, and money in exchange for gold, at a fixed rate. Irving Fisher's plan which has the blessing of most of the younger generation of economists, and in particular of the Cambridge school to which Mr. Keynes belongs, is the same, except

that instead of a fixed rate for gold there would be a rate varying with an index number of general prices in accord with a published schedule, in such a way as to fall below the market price of gold as the general price level rose and to rise above it as the general index-number fell. Thus there would be an inducement to buy gold from Government when prices were rising and this would withdraw money from circulation and automatically check the rise in prices. Similarly when general prices were falling people would have an inducement to sell gold to the Government, thus compelling the Government to put more of its token currency into circulation and thereby send prices up to the old level.

For it cannot be said that the gold standard has ever secured stability of prices and the modern economists hold that stable prices, which would prevent the recurring cycles of boom and slump, of overtrading followed by unemployment, are, if they can be achieved, of more importance than an invariable rate for the conversion of token money into gold. Some day such a plan might lead to the elimination of gold altogether and the enthronement of index-numbers as a standard of value throughout the monetarily United States of Europe and America.

Meanwhile gold has undoubtedly come back in a new and modified guise; and there is much to be said for going one better than the gold exchange standard and introducing the gold bullion standard into India. The strongest argument of those who advocated the gold currency standard has always been that the free convertibility of currency into gold coin would stimulate the habit of banking. People would, it is said, give up hoarding once they were persuaded that they could always have gold and that their hoards would be kept for them by a bank in gold. It is not a conclusive

argument, for, as Lord Cromer once wrote in a report, the drain of gold into the sands of Egypt that took place under a gold currency system was appalling, and in the Ottoman Empire also hoarding was more noticeable than banking. Doubtless however things would have been worse without convertibility, and certainly the spread of banking and investing habits is one of India's most urgent needs. Whatever is possible should be attempted. The gold exchange standard does not help at all in this direction, but the gold bullion standard should have the same advantage as the gold currency standard.

CHAPTER VIII.

A GOLD BULLION STANDARD.

A currency which will be convertible on demand into gold bullion would give a real and abiding stimulus to the banking habit. A hoard of gold can then be much more safely and profitably kept in a bank than in a hiding place. If India achieves a gold bullion standard she will be in exactly the same position as Great Britain, and will have every reason to congratulate herself. In Great Britain there is a minimum amount below which the Bank of England is not compelled to buy or sell gold, namely, 400 oz. of bullion, and a similar restriction can naturally be enforced in India without impairing the public confidence in the standard, since there will be no maximum limit either for buying or selling.

The advantages will be that there will be no gold coins in circulation, and consequently no displacement of the silver rupees and notes now current. Gold is already freely to be had in the market in India, which imports large quantities of it, and for hoarding purposes it is driving out silver, but when gold can be hoarded at interest on deposit in the banks this tendency will be diminished. The extra demand for gold in order to inaugurate the system safely will be limited to the amount required for strengthening the gold in the currency reserves. The silver market is displaying nervousness but should scarcely be affected at all, for it is already understood that India has got all the silver coins it needs and is not likely to be a buyer in the market for a long time to come. A portion of the rupees in the currency reserve may have to be melted and sold as bullion, but this would probably have had to be done anyhow, as owing to the heavy coinage of rupees in the

War period and to the subsequent slump, as well as to some increase in banking and investing habits, there is a still growing accumulation of silver rupees surplus to currency requirements.

So much for advantages, but there are also difficulties in the way of an introduction of a gold bullion standard. A statutory obligation to give gold in exchange for local currency in all circumstances above a certain minimum amount goes beyond anything undertaken in pre-war days. In the West such an obligation can be accepted with a lighter heart than in India, for there the public demand for gold for non-currency purposes is negligible, and the demand on currency account is practically limited to a demand for exporting when, owing to a weakness in exchange, it is cheaper to settle trade bills in gold than to purchase foreign currency. In India, on the contrary there is a large demand outside currency for gold for hoarding, and for the kindred purpose of investing in gold ornaments. This demand is at present met by the bullion market, which buys gold abroad and sells at a price which covers the cost of transport and leaves a profit to the dealers. If the currency authority were to accept an obligation to give gold for currency exactly at the par value of the rupee, it is evident that everybody would get any gold required for non-monetary purposes in this way, the total cost of importing it would be flung upon the tax-payer, and the wholesale bullion market would be destroyed.

To meet this difficulty and to ensure that the currency authority shall not in normal times be asked to supply gold for non-monetary purposes, the Commission has devised an ingenious plan. The selling price of gold is to be fixed at rates which will enable the Reserve Bank to replenish its stock of gold without loss by importation from London. Thus when exchange is at the upper

gold point the selling price for delivery at Bombay will be the par value, i.e., Rs. 21-3-10 per tola, "When exchange is below this point the Bank will be required to sell gold for delivery in London or Bombay, at the option of the purchaser, at certain notified prices. These prices will be determined by the cost at which gold could be respectively purchased in London or laid down in Bombay from London when exchange is at the lower gold point. The option to the purchaser on the other hand to buy gold for delivery in London at the prices determined leaves the margin between the upper and lower gold points of the exchange as narrow as it could be, having regard to the cost of moving gold to and from its most convenient gold centre."

An unlimited obligation to give gold in exchange for currency certainly involves keeping larger reserves of gold than has hitherto been the custom in India, and therefore the taxpayer will lose the interest on that portion of the reserve which will have to be transferred from interest-bearing securities to gold.

The gold standard reserve, accumulated between 1898 and 1914 as a special reserve for redeeming surplus rupees, is made up of the difference between the cost of bullion and its minting on the one hand and its face value when issued to the public on the other, and there is also some accumulation of interest on the securities held in the reserve. The total is now £40 million, and as it is now to be amalgamated with the paper currency reserve there seems no reason why the issuing authority should not have ample means for maintaining the whole of the rupee currency, silver and paper, at the fixed rate in terms of gold, and providing for any possible demand for gold or foreign currency.

CHAPTER IX

THE RESERVE BANK.

With a gold bullion standard, clearly there will have to be a single authority responsible for the maintenance of exchange, in control of the discount rate, and disposing of the currency and banking reserves of the country. At present responsibility is divided. The Government of India and the India Office between them maintain the rate of exchange, and pass remittances between London and India not merely to meet their own charges but for the expansion or contraction of currency. Formerly the Presidency Banks controlled and now the Imperial Bank controls the discount rate and credit issues in India. This division clearly will not do. If we are to have a gold standard, we shall require a bank of issue for all these purposes.

In the Imperial Bank we now have a central authority which keeps nearly all Government balances—there are still a few separate treasuries where the bank has not yet opened a branch—and on a first consideration of the subject it seemed indicated for the rôle of bank of issue. But the Commission, when they came to examine the problem, could find no means of reconciling the transformation of the Imperial Bank into a bank of issue with its position as a commercial bank or with the interests of the exchange banks. The work of Central, or Reserve Banks, or Banks of issue, in other countries is thus described:—

“Their business, in the main, is confined to that of a bank of the banks and of the Government. These functions of necessity require that the character of their business should be of the soundest. Such limitations upon their business prevent these Central Banks from transacting the

every-day commercial banking business of the country or from entering into competition with the commercial banks in any general sense. But in times of stress they intervene vigorously in the country's business by extending credit facilities liberally. They are primarily concerned with upholding the credit of the country and guiding its financial policy."

Now the Imperial Bank has already over a hundred and sixty branches; and unless these branches are to be merely a new camouflage for the old Government treasuries they must be allowed to do some ordinary commercial banking, otherwise the country will lose the advantage of an organisation specially adapted to encourage the habit of banking. It is difficult to reconcile such freedom with the restrictions that seem necessary in the case of a Reserve Bank, though it has been suggested that a way out might be found by turning the Imperial Bank into an institution more on the lines of the Bank of France than of the newer Central Banks of modern times. But not only would the Imperial Bank have to be deprived of some of its freedom in commercial banking before it could be put in control of the currency and the reserve, but it would also have to receive more freedom in the field of exchange than it has at present, and here the exchange banks would regard it as a formidable and privileged competitor. A new and exclusively Reserve Bank which is not in the commercial field will not be inimical to the exchange banks, for it will work on their behalf, and they should profit from a well-managed discount rate and satisfactory internal currency conditions in India.

Sir Purshotamdas Thakurdas in his minute of dissent agrees that it is imperative that the Imperial Bank should be allowed to go on with its work of opening up new branches, but he holds

that the creation of a new Reserve Bank might impair the prestige and authority of the Imperial Bank, and that no division of the Government funds between it and another institution should be permitted to restrict its capacity to open new and even temporarily unprofitable branches. Moreover, he holds that the limited popularity of drafts in India will mean that there will not be a large enough volume of re-discounting business for the new bank to do at first, since the Exchange Banks would, he holds, go to the Reserve Bank to re-discount external bills only when its rate is lower than the London rate. Either therefore the Reserve Bank and the Imperial Bank would have to compete with each other, or the former would not find sufficient scope to employ its funds.

Sir Purshotamdas Thakurdas accordingly recommends the evolution of the Reserve Bank from the existing Imperial Bank of India, but he agrees that this would necessitate restriction of the earnings of the Imperial Bank, and finally concludes that "unless the shareholders of the Imperial Bank agree to such restriction of their dividends there will of course be no alternative left but to start a new Central Bank." As this is not an improbable contingency the difference between Sir Purshotamdas and his colleagues on this point may be unsubstantial.

Moreover, the fact that the majority report is signed by Sir Norcot Warren, a Managing Governor of the Imperial Bank, and that of four other signatories closely connected with the Bank none but Sir Purshotamdas Thakurdas expressed misgivings would seem to show that this institution does not regard itself as unfairly treated in any way. Indeed, the arrangements proposed for the original capitalization of the new reserve bank show that though its management is to be separate it will in effect be so closely allied with the Imperial

Bank that it might more suitably be termed the Imperial Reserve Bank of India than merely, as the Commissioners suggest, the Reserve Bank of India. The Imperial Bank shareholders are to be given the first opportunity of subscribing the whole of the capital stock. As it is proposed to pay a cumulative dividend of five per cent and shareholders will be entitled to participate up to a further three per cent as soon as a reserve equal to the original capital has been built up, this seems an exceedingly valuable concession, being in fact the right to buy what promises to be an eight per cent gilt-edged security at par. Some modification of these terms may be proposed in the Bill which will be submitted to the Indian Legislature, and it is probable that the original dividend suggested will be six per cent rising ultimately to $7\frac{1}{2}$. Moreover, if the proposals in the report are to be adopted in the bill, the central board will consist of fourteen members of whom nine will be elected by shareholders, and as these shareholders are likely to be simply the Imperial Bank shareholders over again, this means that the local boards of the two banks will tend in practice to be the same. Furthermore, it is suggested that the reserve bank will employ the Imperial Bank as its agent in the mofussil, and will, "in consideration of this service, place at the disposal of the Imperial Bank such funds, and for such periods as would be required to enable the Imperial Bank's branches to become self-supporting." This will probably mean a free balance of three or four crores, and there will presumably be agency fees as well. All things considered, the fear that the Imperial Bank may suffer does not seem a substantial one, and it is likely to be fully compensated for the modification of its charter.

The new Reserve Bank will have to take the

Government into partnership, and, after paying a limited maximum dividend to the shareholders which can subsequently be increased when a reserve equal to the original capital has been built up, find something wherewith to compensate the taxpayer for foregoing his profit on the issue of currency notes and favourable Government remittances. But this does not mean that there should be an increase of Government intervention in the bank's affairs. At the Genoa conference emphasis was laid on the necessity of eliminating politics from the purely professional control of currency and credit by central banks, and if business is always to predominate over politics Government intervention should be reduced to a minimum.

The bank should exclude from its management of the discount rate all considerations except those which should help it to determine the supply of currency so as to ensure the absolute stability of the exchange value of the rupee. But the arrangements for the supply of currency should under the new arrangement be more elastic than they now are, and better adapted to the seasonal variations of demand, since there would be co-ordination of the banking and currency reserves.

The Secretary of State's balances in London will under such a system have only to be maintained at a figure sufficient to cover his immediate requirements. The Reserve Bank will provide him from month to month with whatever is needed for India's official liabilities in London, and the Government of India will have to keep balances with the bank sufficient to pay for these sterling drafts. The India Office will no longer have to accumulate balances, or to lend large sums in London on account of Ways and Means balances, or paper currency reserve and gold standard reserve balances.

These would be great gains, and there is much more that might be said to illustrate the practical advantages of a gold bullion standard controlled by a central bank of issue.

It means financial and currency autonomy for India.

CHAPTER X.

THE RATIO.

What is the ideal rupee rate for India if the rate is to be fixed? The answer would probably always be—the average rate of the previous year.

Trade, as we have seen, is an exchange of goods and services, and in international trade no money ordinarily passes from one country to another, the whole account being settled in goods and services of some kind. There is therefore no answer to the statement that when the rupee is higher than usual, this means that for a time India gives less than she gets; in short by normal standards she compels the rest of the world to a certain extent to work for her for nothing until prices adjust themselves. On the other hand when the rupee is lower than usual she is compelled, in order to settle the balance of trade, to export more goods and services than she receives.

For the country as a whole, therefore, if the exchange must fluctuate there is more profit in a rise than a fall. That is why Germany and France respectively regarded the collapse of the mark and the franc as vast national catastrophes, that also is why all the bankers in England have insisted on raising the fallen pound sterling to the value of the gold sovereign, or in other words to the value of 4·86 American dollars. But in a manufacturing country there is another side to the question and many English industrialists, in opposition to the bankers, argue that the gold standard has been reintroduced in England too soon. With a considerable show of reason not a few of them allege that the coal strike was largely due to a premature return to gold.

For there are limits to the success with which you can attempt to make other nations work for you for nothing, and one result, which for a nation depending, as England does, largely on its export trade is calamitous, is that you can make your goods so dear that other nations can no longer afford to buy them. While the franc is low everybody wants to buy things from France, but while the pound is high nobody is so keen on buying things from England. The return to gold parity has facilitated our export trade with America; but it has injured our export trade with Europe.

tariff.

From the point of view of the manufacturer a fall in exchange is more efficient than a protective ~~tariff~~. For whereas a tariff only protects him in the home market, an exchange which is low in comparison with that of other countries not only checks the flow of their imports into his country but also facilitates the flow of his exports to them. That this unquestionably means that his countrymen become to some extent the slaves of the countries with the higher exchange, and have to work for an inadequate reward, does not cost him a night's sleep so long as he can sell his goods. And up to a point he has reason on his side. For if the exchange is too high, as has probably been the case with the English pound vis-a-vis the other European currencies in the last two or three years, a country which lives ordinarily by manufacturing for the export markets suffers heavily from unemployment, whereas in countries like France, where the exchange value of the currency has heavily slumped, there is no unemployment at all.

India on this issue, largely through the lack of economic knowledge, seems to be the land of topsy-turvy. In respect of the total volume of her trade she is beyond question an agricultural country, and can hardly be said to be a manufacturing country at all. Yet whereas all the

countries of Europe, although they have much greater manufacturing industries to protect in their own home markets, have been making frantic efforts not, it is true, to restore the pre-war parity but to check the depreciation of their currencies, the most vocal section of Indian opinion on currency,—namely the Bombay millowners,—has been clamouring for a depreciation of Indian currency. The millowners want to see the rupee back at one-and-four because that would for a time tend to check the flow of the goods and services of Lancashire and Japan into this country, and compel India to give them more than she receives. It is true that once it was realized that the new rate was to be permanent prices would begin to adjust themselves. The Bombay cotton industry is of great importance to the future of the country and must be preserved, so that were the currency Commission to advocate a rise in the rupee which would temporarily flood India with European manufactured goods at a cheap rate, although we of the general public might rejoice because until prices adjusted themselves we were getting something for nothing, and to some extent making Europe our helot, yet the Bombay manufacturer might reasonably complain that his individual business had been ruined by cheap prices. But on the other hand the Bombay millowner represents a very small part of India's trade, though potentially an important one. India's mainstay is agriculture—raw cotton, jute, rice, tea, and cereals of various sorts. These need no protection in the Indian home market, and like the millowner in the long run, have most to gain from a steady exchange which facilitates forward contracts at known prices. So long therefore as the rate is not so high that it acts as a restraint on trade, clearly the country as a whole must benefit by keeping it steady at its present figure.

But it is not merely as a temporarily protective measure that the millowners want the rupee depreciated. When the temporary effect had passed a new and permanent result would be obtained. The general level of prices in India would have been raised. A rupee worth 1s. 4d. would not buy so much as a rupee worth 1s. 6d. Consequently prices would be raised against the consumer. For every eight rupees which he paid out before he would now pay exactly nine, and for every 100 exactly 112½,—that is to say there would be a rise of 12½ per cent. in the cost of living. The millowners do not propose to compensate their employees for the increased cost of living but to pocket the difference. The owners would sell their cloth at higher prices but would pay the men less real wages. This point was very fully explained by Sir Victor Sassoon in his evidence before the Royal Commission. Speaking as the representative of the Millowners Association he argued that the men are needlessly overpaid.

Although he admitted that they are now “buying luxuries they could not afford before” such as imported cloth, and that “the demand for money-orders to the districts from which these men come has increased tremendously,” yet he somewhat paradoxically declared that there had been no rise in the standard of living, but only in “expenditure which is not necessary,” and he frankly advocated the depreciation of the rupee in order to lower the workmen’s real wages for the benefit of the employer. If the wages were openly reduced there would be strikes, whereas if the wages were unobtrusively lowered by diminishing their purchasing power, the men might not realize their loss. “We are taking away something that they got by luck and never expected.” When asked by the Chairman what benefit the one-and-

fourpenny ratio would confer upon the cotton industry, Sir Victor Sassoon candidly replied:— "I think in the first place it would mean a reduction of twelve per cent in wages. . . . I don't think speaking generally that if you went back to 1s. 4d. there would be any consequent rise in wages, certainly not in our industry, and not for a large part of India. I think it would probably lead to higher prices for certain produce like cereals and pulses, and we as mill-owners would welcome that." So there is the issue plainly stated by the Chairman of the Currency League. One-and-fourpence means lower real wages and higher prices, and when we are told that higher prices of food will benefit the cultivator, it is fair to ask what is going to be done for the labourer and for the millions of landless people who will find the purchasing power of all their meagre earnings reduced.

Those who advocate the depreciation of the rupee profess to be extremely solicitous for the agriculturist. It is a little difficult to take this argument seriously. A pamphlet by Mr. B. P. Madon published by the Currency League called "The 18d. Ratio: Its Ruinous Results" states a case which admirably illustrates the fallacy which underlies the argument. Let us quote it textually.

An Example—its lessons.

Suppose a man called "A" has shipped Cotton to Europe and realised £1,000 in London.

Suppose another man "B" has ordered a motor car and has to pay £1,000 in London.

"A" goes to the Banker and asks him to collect the £1,000 from his *adatyā* and bring it to India.

"B" goes to the Banker and asks him to send £1,000 to his Agent in London for that motor car.

The position then is

A wants to	B wants to
bring back £1,000.	send £1,000.

The Banker asks B to pay the equivalent in Rupees to the Bank. When B pays it the Banker pays it to A, and gets A to instruct his agent in London to pay that £1,000 to that Bank. The London office of that Bank receives it and pays it to B's agent for the motor car. The Bank gets a small commission from A as well as B for doing this work, but no money actually goes out of India or comes to India. What happens is that money already in London in the hands of A's agent is transferred to B's agent through the intermediary of the Bank. We call such transactions Exchange transactions because the net result is that A's cotton is exchanged for B's motor car.

Now the question arises how much money it is that B should pay to the Bank, because, as will be seen from the above, it is this sum that the Bank passes on to A in Bombay. Therefore if the Government has fixed the rate at 16d. as it was in pre-war days

B will have to pay Rs. 15,000 for his car

A will receive Rs. 15,000 for his cotton

and each will pay the Banker a small commission for the trouble. If the Exchange is 18d. to the Rupee as the Government has now made it, B will be called upon to pay only Rs. 13,333 for his car but A will get only Rs. 13,333 for his cotton.

Quite so. But that the Rs. 13,333 in the second case are just as good as the Rs. 15,000 in the first case is proved by the fact that if A wishes to do so he can buy with them the motor-car which formerly cost B Rs. 15,000.

Once the inevitable all-round rise of 12½ per cent in prices, which must follow a depreciation of the rupee from 1s. 6d. to 1s. 4d., has taken place, this rise will be permanent if the rupee is stabilised at that figure. The cultivator who gets more depreciated rupees for what he sells will have to give more depreciated rupees for all that he buys, and will not, generally speaking, be affected at all. The only case in which he can profit is if he employs labour and refuses to increase its wages.

In that case he can make a profit out of those poorer than himself.

This is what the mill-owners propose to do, and the explanation of the controversy over the rupee ratio is to be found in the fact that the one place and the one commodity in which Indian prices have not adjusted themselves already to the 1s. 6d. level are represented by Bombay and its labour.

Bombay is the exceptional case. There the millowners pay higher wages than the owners in other parts of India, and consequently a great deal of the competition from which Bombay suffers is internal. But it does not seem reasonable to settle a local industrial problem by depreciating the currency at the expense of the whole country. Everybody's money would buy less, not temporarily but permanently. The Government of India and all the provincial Governments would find that their budgets no longer balanced, and they would be compelled to impose new taxation to meet the 12½ per cent rise in their expenditure.

Sir Purshotamdas Thakurdas argues that Europe is trying to get back to the pre-War ratio and that India should do the same. Europe's currency has depreciated and India's has appreciated, therefore Europe should go up to the old parity and India should come down to it. The reply to this is that Europe is seeking to do nothing of the sort. No country but Great Britain has gone back to the pre-War parity, and the sacrifice she is making for it in the form of industrial unrest and unemployment is daily becoming more evident, although her currency never depreciated to the extent that it did in other countries. Germany, Russia, Austria, Czecho-Slovakia and Yugo-Slavia have all recognized that an attempt to return to the pre-War parity would be ruinous.

Belgium has just stabilized the franc at 175, and France, having got her ratio to the neighbourhood of 150, is nervous lest it improve too rapidly and thereby greatly increase the burden of real taxation for 1927, which already promises to be far heavier than in 1926. That eminent authority Professor Gustav Cassel disposed of this argument when he said before the Currency Commission : " The idea that the rupee must necessarily be restored to the pre-War gold parity of 1s. 4d. has a striking resemblance to the programme of raising depreciated currencies to their pre-War parity, which has played such an unfortunate rôle in the recent monetary policy of many European countries. If no better reason can be given for choosing 1s. 4d. as the value at which the rupee should be stabilized, the idea ought to be abandoned, and the sooner the better. If it appears on closer investigation, that the present purchasing power parity of the rupee lies in the neighbourhood of 1s. 6d., a lowering of the value from 1s. 6d. to 1s. 4d. means a process of inflation which is just as harmful as the deflation which in some European countries would be required in order to raise the value of the currency to a higher pre-War level. The leading principle must be to stabilize every currency at its present value."

The outstanding fact is that the rate has now been maintained for nearly two years around one-and six. Far more important than either a high rate or a low rate is a steady rate. Wide fluctuations, such as marked the War period, paralyse honest commerce and industry, bring ruin to many homes, and foster all the evils of speculation. It would be quite impossible to justify the dis-equilibrium and deliberate depreciation of India's property,—namely its present claim on the goods and services of the rest of the world,—which would follow on the introduction of a lower rate.

Apart, however, from the argument that it would help the Bombay cotton industry—at the expense of the wage-earners in that industry—we should consider whether there are any circumstances in which a lower rate than 1s. 6d. might be advisable in the interests of India as a whole.

Such a situation is conceivable. In their evidence before the Currency Commission the Governors of the Bank of England and of the Federal Reserve Bank of New York both insisted that the argument for stabilization at the existing rate was largely dependent on the naturalness or artificiality of that rate. Mr. Montagu Norman, Governor of the Bank of England, said:—"As I understand it, though I have not studied the question, it has been generally speaking by natural causes that the Indian exchange has come to be where it is, and to remain there over a long period; and I see no reason to advocate that it should be altered." Generally speaking that is so, but at certain periods there has of course been some manipulation which, though quite legitimate, was the result of an unnatural and chaotic situation. After the failure of the attempt to hold exchange at two shillings, gold, Government supported a sagging rupee by currency contraction, or at least by definitely limiting expansion. This policy went too far, and produced such stringency that to relieve pressure, and prevent undue appreciation of the rupee through scarcity of currency, contrary measures had to be taken. Had not the Government in 1924 bought sterling freely and thereby put rupees in circulation the rate might have soared up to 1s. 9d. or even higher. To-day the situation is changed, and undoubtedly it changed a good deal after the Commissioners framed their report. There is so much currency in circulation and there has been so much stagnation in the export trade owing to the lateness of the

crops that the recent tendency of the rupee, if left to itself, and not upon a gold basis, was to fall. An article from the Exchange Correspondent of the *Statesman* published at the end of this volume provides a good analysis of the situation at the end of November, 1926, and it will be seen that it was entirely abnormal. If this abnormality returned and should it be followed by a bad monsoon or a succession of bad monsoons the downward tendency of a rupee without gold backing would be increased. Indian finance is still "a gamble in rain" and such possibilities cannot be excluded, though 1927 begins with a rising rupee swinging to the upper gold point.

A collapse of the rupee would of course be a vast catastrophe. It is the duty of the currency authority in every country to aim at stability by attention to its reserves and by using the bank rate for the contraction or expansion of credit. India in 1919, attempted stability at the rate of 2s. gold, but her financial resources were so weak that she proved quite unable to control the fluctuations of the rupee in the difficult post-war period.

The advantages of immediate stabilisation are obvious. The only question is whether the world has now sufficiently settled down and whether India's financial resources are equal to the task in face of some abnormal chain of adverse circumstances such as a succession of bad monsoons.

The Finance Member is confident that the answer is Yes. The great improvement in India's finances which Sir Basil Blackett has brought about is evident, and the resources of Government are to-day not to be compared with those of seven years ago. So that his opinion must carry great weight.

It is, however, possible that the Legislature may wish the proposals of the Currency Com-

mission, when embodied in a bill, to be circulated for opinion and that the issue may stand over till the Autumn of 1927. This would enable the country to see for a longer period the ease or otherwise with which India can now maintain its rupee stable in face of possibly trying conditions. It would of course be the duty of the Finance Member to keep it pegged at 1s. 6d. in accordance with the Commission's recommendations and Government's own declarations, so long as it was feasible to do so. On this point the Government's spokesmen express no doubt whatever.

There is one aspect of government in India under the Montagu-Chelmsford Act which should not be forgotten in connexion with currency. A Government which cannot resign when its measures are defeated must go further to meet the wishes of the Legislature than a Ministry which can by resignation throw the responsibility on the Opposition. An agreed measure is worth ten bills which have to be certified. In the circumstances of the time, a certified Currency Bill would be a disaster.

APPENDIX I.

Summary of Recommendations of the Royal Commission on Indian Currency and Finance. (1926.)

(i) The ordinary medium of circulation should remain the currency note and the silver rupee, and the stability of the currency in terms of gold should be secured by making the currency directly convertible into gold, but gold should not circulate as money. (Paragraph 54.)

(ii) The necessity of unity of policy in the control of currency and credit for the achievement of monetary stability involves the establishment of a Central Banking system. (Paragraphs 83-85.)

(iii) The Central Banking functions should be entrusted to a new organisation, referred to as the Reserve Bank. (Paragraphs 89, 90.)

(iv) Detailed recommendations are made as to the constitution (paragraphs 91-102) and functions and capacities of the Bank. (Paragraphs 139-164.)

(v) The outlines of a proposed charter are recommended to give effect to the recommendations which concern the Reserve Bank. (Paragraphs 139-164.)

(vi) Subject to the payment of limited dividends and the building up of suitable reserve funds, the balance of the profits of the Reserve Bank should be paid over to the Government. (Paragraphs 99, 100.)

(vii) The Bank should be given the sole right of note issue for a period of (say) 25 years. Not later than five years from the date of the charter becoming operative, Government notes should cease to be legal tender except at Government Treasuries. (Paragraph 141.)

(viii) The notes of the Bank should be full legal tender, and should be guaranteed by Government. The form and material of the note should be subject to the approval of the Governor-General in Council. A suggestion is made as to the form of the note. (Paragraphs 138, 149, 155.)

(ix) An obligation should be imposed by statute on the Bank to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold is required. (Paragraphs 59-61, 150, 151.)

(x) The conditions which are to govern the sale of gold by the Bank should be so framed as to free it in normal circumstances from the task of supplying gold for non-monetary purposes, The method by which this may be secured is suggested. (Paragraphs 64, 150.)

(xi) The legal tender quality of the sovereign and the half-sovereign should be removed. (Paragraphs 65, 66.)

(xii) Government should offer "on tap" saving certificates redeemable in 3 or 5 years in legal tender money or gold at the option of the holder. (Paragraphs 67, 68.)

(xiii) The paper currency should cease to be convertible by law into silver coin. It should, however, be the duty of the Bank to maintain the free interchangeability of the different forms of legal tender currency, and of the Government to supply coin to the Bank on demand. (Paragraphs 69-71, 152.)

(xiv) One-rupee notes should be re-introduced and should be full legal tender. (Paragraph 72.)

(xv) Notes other than the one-rupee note should be legally convertible into legal tender money, i.e., into notes of smaller denominations or silver rupees at the option of the currency authority. (Paragraph 73.)

(xvi) No change should be made in the legal tender character of the silver rupee. (Paragraph 74.)

(xvii) The Paper Currency and Gold Standard Reserves should be amalgamated, and the proportions and composition of the combined Reserve should be fixed by statute. (Paragraphs 75-77.)

(xviii) The proportional reserve system should be adopted. Gold and gold securities should form not less than 40 per cent. of the Reserve, subject to a possible temporary reduction, with the consent of Government, on payment of a tax. The currency

authority should strive to work to a reserve ratio of 50 to 60 per cent. The gold holding should be raised to 20 per cent. of the Reserve as soon as possible and to 25 per cent. within 10 years. During this period no favourable opportunity of fortifying the gold holding in the Reserve should be allowed to escape. Of the gold holding at least one-half should be held in India. (Paragraphs 78, 79, 131, 132, 153.)

(xix) The silver holding in the Reserve should be very substantially reduced during a transitional period of 10 years. (Paragraphs 80, 133-136, 145.)

(xx) The balance of the Reserve should be held in self-liquidating trade bills and Government of India securities. The "created" securities should be replaced by marketable securities within ten years. (Paragraphs 81, 116, 136, 145.)

(xxi) A figure of Rs. 50 crores has been fixed as the liability in respect of the contractibility of the rupee circulation. Recommendations are made to secure that an amount equal to one-fifth of the face value of any increase or decrease in the number of silver rupees in issue shall be added to or subtracted from this liability, and the balance of profit or loss shall accrue to or be borne by the Government revenues. (Paragraphs 82, 120-123, 146-148.)

(xxii) The Issue Department of the Reserve Bank should be kept wholly distinct from its Banking Department. (Paragraphs 137, 143.)

(xxiii) The Reserve Bank should be entrusted with all the remittance operations of the Government. The Secretary of State should furnish in advance periodical information as to his requirements. The Bank should be left free, at its discretion, to employ such method or methods of remittance as it may find conducive to smooth working. (Paragraphs 103-109, 111, 140.)

(xxiv) During the transition period the Government should publish a weekly return of remittances made. A trial should be made of the system of purchase by public tender in India. (Paragraph 110.)

(xxv) The cash balances of the Government (including any balances of the Government of India and of the Secretary of State outside India), as well as the banking reserves in India of all banks operating

in India, should be centralised in the hands of the Reserve Bank. Section 23 of the Government of India Act should be amended accordingly. (Paragraphs 111, 112, 140, 161, 162.)

(xxvi) The transfer of Reserve assets should take place not later than 1st January, 1929, and the Bank's obligation to buy and sell gold should come into operation not later than 1st January, 1931. (Paragraph 165.)

(xxvii) During the transition period the currency authority (i.e., the Government until the transfer of Reserve assets and the Bank thereafter) should be under an obligation to buy gold and to sell gold or gold exchange at its option at the gold points of the exchange. This obligation should be embodied in statutory form, of which the outline is suggested. (Paragraph 166.)

(xxviii) Stabilisation of the rupee should be effected forthwith at a rate corresponding to an exchange rate of 1s. 6d. (Paragraphs 168-213.)

(xxix) The stamp duty on bills of exchange and cheques should be abolished. Bill forms, in the English language and the vernacular in parallel, should be on sale at post offices. (Paragraphs 116, 216.)

(xxx) Measures should be taken to promote the development of banking in India. (Paragraph 214.)

(xxxi) Every effort should be made to remedy the deficiencies in the existing body of statistical data. (Paragraph 217.)

APPENDIX II.

Sir Basil Blackett's speech at Delhi University, Nov. 23, 1926.

The first observation I have to make is that it is misleading to talk and think of the question as one between a ratio of 1s. 4d. and a ratio of 1s. 6d. Neither side advocates the fixation of exchange in terms of sterling or even of British gold money, and unless we first get it clearly fixed in our minds that to talk of a 1s. 4d. or 1s. 6d. ratio is merely to use a convenient, though inexact, description, we may easily fall into error. The advocates of 1s. 4d. desire that the statutory ratio of the rupee should be fixed at 7'5334 grains of gold; the advocates of 1s. 6d. propose that it should be fixed at 8'4751 grains of gold. This distinction of terminology is important in that it is desirable to stress the fact that under the Currency Commission's proposals the standard of value in India will no longer be either the rupee or sterling, but gold and gold alone.

A DEAD ISSUE.

My main difficulty in dealing with this question is that there seems to be very little to argue about. I said in Rangoon that the question between 1s. 4d. and 1s. 6d. is a dead issue. This is not an argumentative proposition; it is simply a statement of fact. The question will of course come before the Legislature again. But to anyone who really goes deeply into the matter the proposal that having at last painfully attained stability we should suddenly and violently alter the ratio from 1s. 6d. to 1s. 4d. and forego all the advantages gained by stabilisation during the last two years, and deliberately start a new and painful period of disequilibrium with all that it entails, is simply unthinkable. There is evidence, as is not unnatural in such matters, of considerable confusion of thought in what is said and written on the subject. I admit at once that an arguable case can undoubtedly be made out for the view that in the course of the last four years the Government of India ought to have managed things differently, so that the ratio might now have been 1s. 4d. gold, that is 7'5334 grains to the rupee. I do not accept this criticism and have more than once

explained my reasons. But it has some strong supporters. For example, it is held by Sir Stanley Reed who nevertheless comes to the conclusion that it is right to retain 1s. 6d. now. As Sir Stanley recognises, it is only as a theoretical proposition relating to what might have been, not as a guide to what is now practicable, that it can be reasonably argued. Yet many of the arguments used in favour of reducing the ratio to 1s. 4d. now are simply an echo of the arguments for that proposition.

GOVERNMENT MANAGEMENT.

The view that the Government of India ought to have managed things differently so that the ratio might now have been 1s. 4d. gold involves the admission that the ratio has necessarily depended on Government management. At the very beginning of my memorandum submitted to the Currency Commission (Appendix VII) I wrote as follows:—"The currency of India, as of almost every other country in the world, was driven away from its moorings by the war, and as in the case of the U. K. till last April, it now consists of an inconvertible medium of circulation (the note convertible into the rupee and the rupee in essence an inconvertible note printed on silver) whose value both for internal and external purposes has depended on the supply in relation to the demand, that is, has been the resultant of the three factors of world prices, internal trade conditions, and the Government's policy in controlling the available supply. Of these three factors, the last has on the whole been the least important, though its importance has been continually increasing as conditions have become more normal and demand has overtaken supply." The ratio of 1s. 4d. could only have been brought into effect and maintained by more intervention, not less intervention on the part of the Government, that is, by more management or, as our opponents like to call it, manipulation. In order to provide a more abundant supply of currency and thereby to depress the value of the rupee to 1s. 4d., more currency would have had to be created by the Government.

Curiously enough, the advocates of 1s. 4d. avoid using the word management or manipulation when the Government add to the currency; they look on with approval when currency is being expanded, but when the Government refrain from expansion and still more

when they contract the currency, their action is denounced as illegitimate and characterised as manipulation. I have said again and again that I think the present currency system and practice put an undue responsibility on Government in this matter; that is one of my strongest reasons for advocating change. But so long as that responsibility exists, the Government cannot refrain from exercising it. If they had neglected their duty and done nothing since the beginning of 1923, either to expand or to contract the currency, we should indeed have had all sorts of violent fluctuations, but the tendency would have been for the rupee to rise much higher than 1s. 6d. The attempt to picture 1s. 4d. as the natural ratio and to accuse the Government of maintaining a higher rate by manipulation turns out therefore to be a complaint that the Government have not done as much manipulation as the advocates of 1s. 4d. would have liked. In so far as either ratio can be called natural it is the ratio of 1s. 6d.

ERRONEOUS IDEA.

Behind this dislike of contraction and affection for expansion there seem to lurk not only the usual inflationary tendencies which were rampant a few years ago in the Continent of Europe and were not unrepresented in England, but also the erroneous idea that a currency must always naturally expand. This idea seems to be based mainly on too close attention being paid to what happened in India from 1900 to 1914, quite apart from what happened during the war. During that period world prices were steadily rising, and Indian prices even more steadily. In India this was a reflexion not only of the increase in world prices, but also in part of the increase of population and of the small but gradual rise in the standard of living. In a period of rising prices it is natural that currency requirements should expand.

The position to-day is quite different. World prices fell rapidly in and after 1920 and have on the whole tended to fall throughout the last four years. Currency requirements naturally contracted with the fall in prices. In England for example the total of Bank of England and Currency notes in circulation fell from £438,000,000 on the 30th September, 1925, to £428,000,000 on the 30th September 1926. That there should be a corresponding tendency in India

during this period for currency to become surplus is exactly what would be expected in any case and special factors have been at work in India, such as the replacement of rupees in hoards by gold and an increase in the habit of banking and investing. The Government would have failed in their duty if they had not acted accordingly in order to prevent any risks to stability from arising out of the existence of a surplus of currency in circulation. The recent ease in the money market belies the accusation that the Government have been making money tight.

I have shown that the question whether or not a different course might have been pursued in recent years has no practical bearing on the question whether at this stage 1s. 4d. ought to be substituted for 1s. 6d., and that 1s. 4d. can be brought about only by increased Government manipulation of the currency. The idea of a sudden change from 1s. 6d. to 1s. 4d. has only to be examined to be rejected. A reduction to 1s. 4d. would be conceivable only in the event of the Government's finding such difficulty in maintaining 1s. 6d. as to be compelled to go back on their declaration of intention to maintain that rate. There is not the slightest ground for supposing that anything of the sort will happen. The reserves and the other resources of the Government are ample, as is shown for example by our recent action in strengthening the reserves by paying off 5 crores of created securities out of balances.

The position is very different from that of 1920 when there was a large budget deficit and a frontier war was in progress and when Government were in daily difficulties for money. We have maintained 1s. 6d. without the least trouble and without undergoing even the normal seasonal stringency in the money market during a period of a somewhat unusual character when the rate both for long term and short term money has been considerably higher in London than in India and the beginning of the busy season has been delayed in an unexampled way.

Moreover, though the recommendations of the Currency Commission do not involve any real change in the position regarding India's requirements of silver for currency purposes, they have affected the silver market by drawing attention to the facts, and this has meant an extra strain on exchange. So far from causing stringency in the money market the period of

stability at 1s. 6d has coincided with a period of unusual ease in Indian money conditions. If proof were really needed of the ability of the 1s. 6d. rate to stand up against a strain, proof is there in abundance.

Attempts are being made to import prejudice by representing 1s. 6d. as involving a bounty to the foreign importer, and that good agriculturist Sir Victor Sassoon weeps over what he represents to be the loss caused to the agriculturist by the 1s. 6d. ratio. He was more frank when he told the Commission that the 1s. 4d. ratio would enable him to reduce the real wages of his employés without reducing their money wages, and at the same time enable him to sell his products to the consumers, who consist mainly of the agriculturists and the employés, for a larger number of rupees. A policy deliberately aimed at reducing the purchasing power of all money wages and increasing the price of all that he buys against the consumer will surely not appeal to the Government or the people of India. It goes directly contrary to what must be the aim of every reformer in India, the gradual raising of the standard of living of the masses.

No one maintains that by altering the ratio you can make anything more than a temporary change, and that only as the result of introducing instability, in the general relation between prices of one kind of commodity and prices of another kind. No doubt you can help the middleman temporarily to get bigger profits at the expense of the producer and the consumer, and enable him to take an extra toll both when he is buying from the producer and when he is selling to the consumer. But after a relatively short interval prices must readjust themselves. The re-adjustment takes longer in some cases than in others; in a few cases it may take a very long period indeed, but in the vast majority of cases the change takes place quickly, though many of the processes involved are explosive, as for example, the levelling up of taxation.

CURRENCY LEAGUE.

It is a curious fact that nearly all the arguments of the currency league have been repudiated in advance by Sir Purshotamdas Thakurdas himself. We are entitled to assume that Sir Purshotamdas does not now repudiate the view expressed by him in

his minute of dissent. He cannot now change his ground completely and adopt arguments which are at variance with those views. I ask him therefore to take an early opportunity of repudiating all the arguments of the Currency league which are inconsistent with the view that the only question is whether or not prices have adjusted themselves to the 1s. 6d. ratio. If he did so, the league would have little left to argue about as regards the ratio, and will, I trust, turn its attention to the study and elucidation of the rest of the Report, on which the views of Sir Purshotamdas and his colleagues are in the main in harmony. If the object of the league is really to instruct public opinion impartially on currency questions, it has my hearty support in its beneficent task, and I should be delighted to become a member if it will admit me.

After exposing some errors "both of arithmetic and of logic" in Sir Purshotamdas Thakurdas's minute of dissent Sir Basil proceeded :—

The Report with the minute of dissent was published at the beginning of August, 1926 and later in the month the matter came before Assembly. It seemed to the Government that, the case for 1s. 4d. being based on the argument that it was not too late to reduce the rate from 1s. 6d. to 1s. 4d. because prices had not had time to adjust themselves, they would be failing in their duty to the Legislature if they did not give the Legislature an immediate opportunity to discuss the question before it was too late. I did not agree with the view that prices had not adjusted themselves, and was prepared to argue it. But as was natural in all the circumstances strong pressure was put on the Government from many quarters in the House to postpone the Bill. I made it clear that the Government must and would continue to maintain the 1s. 6d. ratio pending effective discussion in the Legislature, and that every day was destroying whatever validity there might be in Sir Purshotamdas's one argument for 1s. 4d.

It was obvious that in so far as readjustment had not already taken place, it would inevitably tend to complete itself during the six months which must elapse before the question could come before the

Assembly again, and it was a patent fact well understood at the time that postponement of the Bill must necessarily have results hardly distinguishable from acceptance of the *status quo*. My own view is that the arguments of the Commission are conclusive in showing that prices in India had adjusted themselves to the 1s. 6d. ratio to a preponderant degree at the time when their Report was being written. The considerable period which has elapsed since then must have very nearly completed that readjustment if and in so far as it was incomplete then. It is inconceivable therefore that by the earliest date at which the matter can again be brought before the Legislature the readjustment will not be to all intents and purposes complete. I therefore claim Sir Purshotamdas's own minute of dissent in support of the view, which he shares with all his colleagues, that if prices have to a preponderant degree adjusted themselves to the existing *de facto* rate then that rate must be adhered to.

There is a school of people who say "nothing will satisfy us except a gold currency standard—therefore give us a gold currency standard and a gold currency at once." Such an attitude is not helpful. The Commission had before them proposals which had been carefully worked out by the Finance Department for effecting a transition from the present system to a gold standard with a gold currency within a period of about 10 years. I think that anyone who will go honestly into the evidence for and against that scheme will agree that no alternative method of arriving at a gold currency could be framed which would have quicker results. The scheme was unanimously pronounced by the Commission as involving risks to India which it would be unsafe for her to face.

In regard to the question of the gold bullion standard, I find myself in the fortunate position of being almost in entire accord with Sir Purshotamdas. He rejects some of the arguments of his colleagues against the Finance Department's scheme; so do I. Yet he agrees with his colleagues in regarding it as involving greater risks than India ought to take and in preferring to it a different method of approach. I agree with him. The conditions which I laid down in my advocacy of the scheme as pre-requisite to its

adoption have not proved capable of complete realization. As practical men we must recognise that it is not a scheme which can be immediately adopted. Then again as regards a gold currency, I agree with Sir Purshotamdas in regarding it as a stage in currency development which India will probably not be able to avoid even if she wants to. I made it clear in my evidence that I did not regard a gold currency as ideal, but I expressed the view that if India was to reach the system which I regarded as ideal, *viz.*, a currency absolutely convertible into gold but with gold coins not effectively or appreciably in circulation, she would probably have to pass first through the stage of having gold coins available at will into which all other forms of currency would be convertible. I think I am correct in claiming Sir Purshotamdas's complete concurrence in this view.

ROOT OF THE PROBLAM.

The root of the whole problem of Indian currency is the existence of a large quantity of silver rupees and the long continued habit of the people in India of treating them as *the* standard of value, as they were till 1893. As practical men we must recognise that the Finance Department's scheme involved too great risks to be suitable for immediate introduction. We should therefore view with a favourable eye the gold bullion standard recommended by the Commission. If it does not introduce a gold currency at once, and if it makes it probable that the date of the introduction of a gold currency will be postponed longer than was contemplated by the Finance Department's scheme, on the other hand it provides a method by which India can at once reach the gold standard, and, if further experience does not modify her present desire for a gold currency, we can in due time graft a gold currency on to the new standard and reach our aspiration of a gold currency standard more quickly than is practicably attainable by any other method.

The gold bullion standard recommended by the Commission is really stage one of the Finance Department's scheme. It makes gold the sole standard of value and makes the currency of India absolutely convertible into gold, but it so arranges matters that, while gold will always be available in exchange for

currency in India, that gold will remain in the central reserves for use in supporting the exchange value of the currency, but will not go into circulation internally. India will retain complete freedom to buy gold in the market as at present and the bullion market will remain the ordinary source of supply for gold for non-currency purposes in India. The currency authority will not supplant the bullion market or be involved in supplying gold for ordinary internal demands for non-currency purposes.

The Commission do not themselves think that it will be desirable to introduce a gold currency later on. They deprecate the use of gold in circulation in India and anywhere else. But the scheme is so devised as to enable India through her Legislature to convert the gold bullion standard into a gold currency standard with a gold coin available for circulation at some later date when the difficulties of transition from the present rupee standard to the new gold bullion standard have been fully surmounted. Meanwhile India is offered a currency system absolutely based on gold as the one standard of value and for practical purposes indistinguishable from the currency system in force in England to-day.

The essential change from past practice is that the rupee will cease to be the standard form of currency on which all other forms of legal tender depend for their convertibility. In place of this arrangement the silver rupee along with all other legal tender media of circulation will be convertible into specified amounts of gold bullion. This change is perhaps a little obscured by the fact that the unit of account under the Commission's scheme remains the rupee which both etymologically and historically connotes a silver rather than a gold standard. The real significance of the change can be brought out more clearly if we imagine the substitution of a new gold unit of account with a significant name in place of the rupee.

ESSENCE OF PROPOSALS.

The essence of the Commission's proposals for a gold bullion standard is, as I have said, that all forms of legal tender in India should be absolutely convertible into gold bullion. They have rejected

the idea of introducing a gold coin into circulation immediately on grounds which I think we must recognise as conclusive. The right of convertibility into gold had therefore to be given in such a way as to ensure that on the one hand, there should be no risk of the currency of India falling below or rising above its gold value; in other words, that the right of convertibility should be automatically operative; and that on the other hand the currency authority should not be drained of the gold which it holds for currency purposes and forced to supply at the expense ultimately of the tax-payer gold ordinarily supplied for non-currency purposes in India by the bullion market. The Commission have solved this problem by the adoption of two interesting devices. One of these is as old as Ricardo who advocated it more than a century ago and is in actual operation in England to-day, the device of fixing a limit of 400 oz. of gold as the minimum quantity which the holder of legal tender can demand as of right in exchange for his currency from the currency authority. This leaves it to the market to attend to the retail demand for gold, while absolutely assuring to the holder of currency the exchange value of his holding in relation to gold, whether for external or for internal purposes. It is this provision which finally differentiates the gold bullion standard from the gold exchange standard. It is not sterling or dollars or the currency of any other country whatever that is the standard of value for India: that standard is gold and gold alone.

The second device adopted by the Commission is an ingenious one, and so far as I know, it is their own discovery. If the currency authority were required at all times to give 400 oz. of gold in exchange for an equivalent in legal tender at par, whatever the rate of exchange between the rupee and other gold standard currencies, it would be the cheapest market for gold in India for non-currency purposes at all times when the rate of exchange was below the gold import point. Either therefore it would have to try and keep the rate of exchange permanently at the gold import point, which would be undesirable in many ways, and would certainly tend to keep money tight in India, or it would have continually to import gold for non-currency requirements at the expense of the taxpayer and to the detriment of the effective

working of the Indian gold bullion market. The Commission therefore propose that the price charged for gold by the currency authority should include an allowance for the cost of importing gold, and should be so fixed as to set the currency authority free from the task of supplying gold for non-monetary purposes. There would be no charge if exchange were at the gold import point, the point at which the currency authority would be naturally importing gold for monetary purposes.

I need not go into the details of the calculations; they are given in full in the first schedule to the Report. All that is important is that we should understand the essential meaning of this provision. It is simply this: The currency authority will be statutorily required to hold reserves sufficient to enable it in all circumstances to sell gold for export when the rate of exchange falls to the point at which export of gold is required in order to maintain the fixed equation of 8'4751 grains of gold per rupee, that is, to the gold export point, roughly 1s. 5³/₄d. per rupee, and to import gold and buy gold otherwise imported whenever exchange rises to the point at which the import of gold is required to prevent the rupee from rising beyond the equivalent of 8'4751 grains per rupee, that is, to the gold import point, or roughly 1s. 6¹/₄d. per rupee. The currency authority will buy gold tendered to it at any time by giving one rupee for every 8'4751 grains offered, but it will not be compelled to sell gold for non-currency purposes at a rate which throws upon the taxpayers any portion of the expenses of import.

TOO GREAT RISKS.

These devices are open to no objection if we accept the view, as I think we must, that the immediate introduction of a gold currency standard involves too great risks and is not in India's interests. For very similar reasons the circulation of the sovereign and half-sovereign as legal tender in India cannot be permitted during the period of inauguration of the gold bullion standard. The place for gold in this system is in the reserves. When and if the time comes for the introduction of a gold currency in India and the conversion of the gold bullion standard into a gold currency standard, it will in any case probably prove

preferable to mint a special gold coin, say, a gold mohur of twenty rupees, rather than to retain as legal tender a coin which represents a very inconvenient fraction in terms of rupees.

An important recommendation is the proposal for the amalgamation of the Gold Standard and the Paper Currency Reserves. I may perhaps be allowed to refer the studios to my memorandum which appears as appendix VII for a full statement of the case for reform. The anomalous position of the rupee as at once a note printed on silver and a coin with unlimited legal tender privileges into which all other forms of legal tender are convertible has probably been responsible for the long continuance of the unsatisfactory separation between the two reserves, whose functions are or ought to be indistinguishable. It will, I think, be universally agreed that the amalgamation of the two reserves and their subjection to a single set of statutory rules will be a great improvement on the present division into two reserves, one of which, the Gold Standard Reserve, has hitherto been subject to no kind of statutory control.

RESERVE BANK.

PROPOSED UNIFICATION OF CONTROL.

Thus far I have dealt only with proposals for a reform of the currency standard of India. The recommendation of the Commission in favour of the amalgamation of the Gold Standard and the Paper Currency Reserves does something to secure better control by the currency authority and leads naturally to a consideration of the recommendations of the Commission in regard to the nature of the controlling authority. They propose the unification of the control of Indian currency and credit policy under one authority which shall not be the Government. The new obligations to be imposed by statute upon the currency authority make it essential that the control should be unified and that nothing should impede its automatic working.

As things are at present, the Imperial Bank is charged with the duty of supervising the banking reserves of India and making itself responsible for the credit policy of the Indian money market. In order to

assist it in this task it has the control of the balances in India of the Government of India except that small portion which still remains in the revenue treasuries, but it has no control over the balances of the Government of India outside India or over the currency reserves. The responsibility for control of the currency reserves is shared between the Government of India and the India Office and even at the best of times the geographical distance which separates the two authorities who are jointly responsible must inevitably lead to vexatious delay, where rapid and decisive action is imperative if things are to work smoothly. The arrangements for co-operation between the Imperial Bank in its control of credit policy and the authorities responsible for the control of currency policy have worked reasonably well, but have been largely of a hand to mouth character. The unification of control over both the banking and the currency reserves of India and over the currency and credit policies of India under one authority is clearly a desirable reform if it can be achieved.

In the evidence which I gave before the Currency Commission I expressed strong preference for the unification of this control in hands other than those of the Government. My view was and is that the control ought to be in the hands of one single authority, but that authority ought to be in India and ought not to be the Government of India. It would be easy to elaborate the arguments for this view at great length, but I imagine that I am speaking to the convinced.

The recommendation of the Commission is that all the functions of the Government of India and the Secretary of State in relation to control of Indian currency and the issue of notes, all their functions in regard to the management of the Reserves and to the remittance of funds from India for purposes of Government's expenditure outside India, and all work connected with the use of balances outside India for purposes other than the actual meeting of current outgoings (this last change involving an amendment by the Imperial Parliament of the Government of India Act), should be taken away from them, and entrusted to a Central Bank. They propose that that bank should be the custodian of all Government balances in

and outside India, should keep the Government accounts and manage the Public Debt and should have a monopoly of the right of note issue. The Government of India and its legislature will determine the policy once for all by statutory enactment. Thereafter, the whole responsibility will rest with the Bank. Finally, in order to complete the unification of the currency and banking reserves of India, they recommend that all other Banks doing business in India should be compelled by law to keep a minimum proportion of their time and demand liabilities with the same Bank.

COMMISSION IDEAL.

Such is the ideal which the Commission set before us. Can we attain to it? I have heard criticisms as to details. The other banks which cater for the internal banking needs of India, and the Exchange banks, are naturally examining the Commission's Report with a critical eye and trying to estimate the probable effect on their own fortunes of their adoption. But so far as I have been able to judge, the general principles involved have met with a favourable response in almost every quarter. It is recognized on all hands that they offer to India an immense advance towards more than one of her aspirations. At one stroke control of Indian currency and finance will be transferred from a centre situated at some point between Whitehall and Delhi into the sole control of India. And while geographically the control will be in India, the atmosphere in which that control will be exercised will be no longer a Government atmosphere but an atmosphere permeated by the views of representatives of agricultural, commercial and industrial India.

I see no way of evading the conclusion of the Commission. The only avenue of escape from the divided control inseparable from the present system is to accept the Commission's recommendation and set to work to establish the new Reserve Bank of India. And there is no need to feel any regret at this conclusion. Our reluctance to embark on the formidable task of creating the new institution is natural, but the prize is worth securing. For, instead of the present system, instead of a hybrid institution trying painfully to combine incompatible functions, we find

that once the Reserve Bank is established India is not only endowed with a new Central Bank capable of doing immense services for the currency and monetary needs of India, but she retains in full vigour and with undiminished powers, nay with increased powers of service, the old established Imperial Bank, to continue to act as pioneer in commercial banking throughout India. There is no reason why the creation of the Reserve Bank should be viewed with jealousy by the Imperial Bank or with trepidation for their dividends by its shareholders. The Reserve Bank will have to absorb the Currency Department of the Government of India and carry on the work of the currency chests all over India and Burma. But it will be unnecessary for it to open offices of its own in more than three or four places, at any rate in the initial stages of its development. A partnership, profitable to India and to all concerned, can be entered into between the Reserve Bank and the Imperial Bank. The Imperial Bank can retain all the prestige of being the Government banker by entering into an agreement with the Reserve Bank to undertake Government business as agent of the Reserve Bank at all places where branches of the Reserve Bank are not established, and to perform at such branches on behalf of the Reserve Bank such currency functions as are now performed on behalf of the Government. Tentative proposals for such an arrangement have been under discussion between the Government and the Managing Governors of the Imperial Bank and I anticipate no difficulty in coming to terms satisfactory to both parties. It will naturally be a part of any such agreement that the Imperial Bank shall maintain and continue its work of developing banking facilities.

In recompense for undertaking these duties, the Imperial Bank will be in a position to secure remuneration, either direct or in the form of the use, free or at a low rate of interest, of a portion of the Government balances, sufficient when allowance is made for new freedom from restrictions on its dealings in exchange and in other directions, to make up to it for any loss it may incur through surrendering its present contract with the Government. Moreover, by making a new agreement now, it will be free from anxiety as to what might happen in 1931. In these circumstances I have no hesitation in making a

special appeal to India in favour of the proposed Reserve Bank. Let us not underrate the difficulties or shirk the troublesome questions in regard to detail which must arise. But let us make up our minds that we are going to have the Reserve Bank of India to take over for India the control of India's currency policy and of the machinery of credit in India, and to render services to Indian banking which only such a Bank can provide.

APPENDIX III.
THE INDIAN MONEY MARKET.
An Obscure Position.

By the Exchange correspondent of the *Statesman*.

(Reprinted from "The Statesman" of Nov. 27, 1926.)

The monsoon is a dominant factor in Indian life. On its success or failure depends the prosperity or otherwise of the agriculturist. The buying power of a country which is mainly agricultural is in direct ratio to the degree in which rains have fallen evenly and adequately throughout the land, and the buying power of the masses is linked up with the well-being of national industries and international trade. Only when industries thrive and trade is brisk can the revenues of the Government come up to estimated figures. Thus it comes about that the Finance Member during the "monsoon months" is concerned about the fulfilment of his estimates; the industrialists and the merchants about the turn-over at remunerative margins of profit, and the country at large about the question of a competent living.

The period from the middle of May to the middle of November which is usually designated as the monsoon months is characterized by a feeling of suspense and uncertainty due to the vagaries, generally beneficial but occasionally freakish, of tantalizing Indra. This feeling of uncertainty causes a dullness in economic conditions which is responsible for the monsoon months being also called the "slack season." In the early months of the year jute finance becomes no longer necessary and returns to the city from up-country areas.

ABUNDANT OUTLAY.

Cotton finance in Bombay, wheat finance in the Punjab, and rice finance in Burma afford abundant outlay for money till the end of March and sometimes till the end of April. In any case, by the beginning of May the need of financing crops ceases and thence begins a plethora of money which continues to October-November. Whether the easy conditions of money yield place to hardening conditions in October depends upon the jute crop. If there is an early jute crop, demand for money sets in early in October.

In a like manner the monsoon months witness slack trade. In fact, this period may be fittingly described as one of promise rather than performance, of preparation rather than fulfilment. Trade, beyond hand-to-mouth requirements, is not possible; and the chances of big orders are confined to the fag-end of the season, when the tenor of the rains has become fully known.

With trade stagnant, with money in poor demand, exchange also remains lifeless.

The only market in which there can be activity of a pronounced nature is that of Government securities, which supply the only possible investment to the idle cash balances of the banks. In this period trustees' securities keep in demand and register substantial appreciation in value. This phenomenon is taken advantage of by the Government and the several local bodies, who launch their loan programmes at about the time when money is unlendable, Government securities keep soaring in value, and the minds of investors and bankers are inclined towards investment in "gilt-edgeds" as a welcome utilization for surplus funds.

In many ways this year's slack season stands out as displaying certain unique and even abnormal features.

MONETARY CONDITIONS.

Monetary conditions, which even at the height of the 1926 "busy season" were free from the usual stringency (the bank rate was not raised beyond 6 per cent. this year for the first time since the inauguration of the Imperial Bank) grew easier and easier, and continued void of any activity except for a short spell in the middle of June due to the locking up of funds in the New Loan. Call money has been quoted at half per cent. to three-quarter per cent. for a long time; even at this rate there is very little demand. Banks had no use for term deposits until a short time ago; and the present rate is roughly one per cent. for one month. Term deposits for longer periods are not offered in anticipation of general improvement in trade in the near future.

The large-sized deflation effected by the Government during this period has in no sense led to any brisker tone in the money market.

There are many contributory causes for this phenomenon. The jute crop has been unusually heavy, with a consequent decline in price from 140 (the highest point touched last year) to round about 55. Though the crop is large the finance required this year is not even half that of last year, owing to the prevalent low prices of the raw material. The jute crop was somewhat earlier, but movement therein has been delayed by the "wait and see" policy adopted by the buyers. The result is that there has been no appreciable withdrawal of money on account of jute, and it may be said that jute finance, so far as the money market is concerned, will have no influence. Owing to several causes trade has been at a standstill, and there has been no demand for money for trade purposes.

It is usual, in the circumstances, for surplus cash to be diverted into Government securities, but owing to the débâcle which occurred in June, this market has maintained a nervous tone. Banks have been fighting shy of gilt-edged securities, and the result is a feeling of surfeit unparalleled in the history of the money market for a long time. The cash percentage of the Imperial Bank has remained at an unusually high figure throughout the period, and at the beginning of November it was as high as 44·7 per cent. as against 30·54 per cent. for the corresponding period last year.

THE BANK RATE.

The bank rate was reduced from 6 per cent. to 5 per cent. on 20th May and to 4 per cent. on 10th June. In my review "Finance in 1925-26" published in the *Statesman* of March 31, 1926, I gave the following forecast:—

"This retrospect may well be rounded off with an anticipation of likely events in the monetary world in the immediate or early future. Signs are propitious for the reappearance of 3 per cent. as the lower limit of bank rate for the coming financial year. It is a refreshing feature that bankers pull long faces to-day not for any inability to find funds for the loan applications but for the difficulty of finding remunerative investments; and that they are sweeter on borrowers than on depositors. Money looks like becoming a drug."

My anticipation of unusually easy monetary conditions has proved correct, but not that of a 3 per cent.

bank rate. In this connexion it is the firm opinion in financial circles that the present system of bank rate is unsatisfactory and unreliable as a guide to the exact position in the money market.

The bank rate is to-day an arbitrary whim of the Imperial Bank. There is no definite understanding that the rate should be changed at specified figures of the cash percentage of the Imperial reserve. If there has been any such principle in force, we should doubtless have seen 3 per cent. for a considerable portion of the monsoon months.

As things are at present, the tendency of the Imperial is to reduce the bank rate with the utmost tardiness and reluctance. It should be remembered that the Imperial has a major portion of its advances lent out at a rate of interest which is connected with the bank rate.

A reduction in the bank rate naturally means a reduction in the interest payable on such deposits. The bank authorities are naturally anxious to reap maximum profits, and the result is that the bank rate is kept at higher levels than would be justified by actual money conditions.

RUPEE RATIO.

The exchange market has been subject to an uncertainty more pronounced this year than ever before. Between the obduracy of Bombay, and in a sense of Indian opinion, in favour of the sixteen-penny rupee, and the obduracy of the Government of India, and in a sense of European opinion, in favour of the eighteen-penny, it was a matter of conjecture as to what exactly would be the recommendation of the Hilton-Young Commission. Would they strike a middle course? The hope of a *via media* received support from the continued drooping of exchange.

However, with the announcement of the Currency Commission's recommendation to stabilize the rupee at eighteenpence, a more confident tone was imparted to the market. But it was short-lived. For just a short while exchange went beyond 1s. 6d. only to fall again to just over the lower gold point. At the moment the prevailing rate is 1-5 $\frac{1}{2}$ —a figure that has been possible as a result of deflation. The amount deflated up-to-date comes to twenty crores, including

the cancellation of *ad hoc* securities to the extent of five crores.

The situation is obscure. There is a total lack of confidence or strength. Bills appear in spasmodic and negligible quantities. Signs of trade revival are discernible only to the super-optimist. There is a limit to the amount of deflation possible. Even as it is, there has been a huge outcry in the Indian Press against a policy which has been described as propping up the exchange by manipulation. Will the Government continue deflation in face of opposition? The redeeming feature is that the monetary conditions have been so easy that deflation has produced no complication so far.

SILVER PRICE DECLINE.

A subsidiary effect of the Currency Commission report has been a sharp decline in the price of silver. Silver, which stood at over 68 till July, came down to 56 at the end of October and has rallied to 61. It has been on the downward grade, and the announcement of the Currency Commission's decision did not cause the decline but only accelerated it. Silver is bound to decline as at present the production is in excess of consumption.

The market is to-day in the grip of speculative factors and the silver market has attracted a great deal of attention. To a country like India, which is considered a sink for the precious metals, the career of silver prices has more than a monetary and currency value. It is a matter of universal concern.

GOVERNMENT SECURITIES.

If silver has been erratic, Government securities have been an abnormal feature. Within the three months of March, April and May—i.e., at a period when money is comparatively tight—3½ per cent rupee paper and 5 per cent 1945-55 registered the unprecedented rise of 8 per cent. The New Loan was issued early in June and 25 crores was subscribed in less than three hours. Almost immediately thereafter a severe reaction set in, with the result that prices suffered a daily decline and the 1927-1928 conversion portion of the New Loan was more or less a failure. The decline continued to the end of July, when there was an appreciation by one point.

The securities have kept at this level, there being practically no fluctuation, and the volume of business being on a very restricted scale. During the period under review the Calcutta Port Trust issued a 5 per cent loan of one crore at 97, the whole amount being taken up by the Imperial Bank. The Rangoon Municipality also came into the market for a 5½ per cent loan of half a crore, which was taken up at slightly, over 102. Gilt-edged securities have behaved in an abnormal manner, registering a sharp rise in a comparatively stringent period and a considerable fall in the slack season.

INDIAN CURRENCY AND FINANCE.

(By SIR STANLEY REED, K.B.E., LL.D., formerly Editor of *The Times of India*.)

I.—THE PROBLEM.



THE Indian currency and exchange system has been subject to such incessant controversy for the past half century that the head of one of the great Provinces declared that nobody understood it. There is no mystery, no necessary complexity in either the currency or the exchange position ; reduced to essentials both admit of easy action.

The currency and exchange system officially adopted on the report of the Fowler Committee in 1899—the logical issue of the closing of the Mints to the free coinage of silver six years before—was a gold standard supported by a gold currency, with a permanent ratio of the rupee to the sovereign of 15 to 1, or 1s. 4d. to the rupee. It postulated the free circulation of gold, the free movement of the precious metals, and an increasing holding of liquid gold accumulated from the profit on the coinage of rupees. Unfortunately, the official acceptance of this policy was not made statutory ; the sovereign and the half-sovereign were made legal tender, but the working of the system was left to administrative action. After a first attempt, rendered abortive by the famine conditions of 1899-1900, the attempt to foster the circulation of gold was abandoned. The liquid gold was converted into gold securities ; the gold mint was not established. Instead of the gold standard and gold currency an entirely different standard was set up, with a relatively small circulation of gold, an immense token currency of silver rupees, and of notes convertible into silver rupees, and an insignificant reserve of liquid gold. The rupee was pegged at one shilling and fourpence by the undertaking of the Secretary of State, nowhere made legally binding, to sell Council Bills on India to an unlimited extent, and Reverse Councils on London, at gold point.

What was the standard thus established? It is generally described in London as the gold exchange standard. That status was never claimed for it by the principal protagonist, the late Sir Lionel Abrahams, who described it as a "limping standard." The Royal Commission whose report we are now reviewing declares that "in truth in so far as it amounted to a definite standard at all, it was a standard of sterling exchange." Later, they show that "the automatic working of the exchange standard is thus not adequately provided for in India, and never has been. The fundamental basis of such a standard is provision for the expansion and contraction of the volume of currency. . . . Under the Indian system, contraction is not, and never has been, automatic."

However, the standard limped along until the third year of the war. The exchange value of the rupee was stable; prices adjusted themselves to the ratio; Indian trade and industry developed. From the narrow standpoint of profit and loss, the investment of the reserves, instead of keeping them in gold, resulted in a considerable gain to the finances, estimated in 1925 at £17,962,466. But it had three great disadvantages—it did not inspire public confidence; it placed the Indian currency at the mercy of the silver market, which was on occasion deliberately cornered against it; and it left the control of currency by the Government divorced from the control of credit by the Presidency Banks, afterwards amalgamated in the Imperial Bank of India. On this the Commission make a very suggestive comment: "when allowance has been made for all misunderstandings and misapprehensions, the fact remains that a large measure of distrust in the present system is justified by its imperfections."

There is, I think, an inadequate appreciation of the influence on the Indian currency and exchange of the war, and the action taken thereafter. The first break in the permanent ratio of one shilling and fourpence did not occur until 1917, when the full effect of dependence on the silver market was revealed. Faced by the unprecedented rise in the price of

silver the Government of India had either to raise the price of Council Drafts or else abandon the convertibility of the Note Issue. Wisely, it took the former alternative ; the price of Council Drafts followed the price of silver. The effect of this would have been transitory, but for the attempt in 1920, on the advice of the Babington Smith Committee, to stabilise the rupee at a new ratio of two shillings gold when all gold prices were crashing. It is easy to be wise after the event, but if the Government had followed silver down, as it followed silver up, there is no room to doubt that the rupee would have returned to its " permanent " ratio with no more disturbance than was inevitable under war conditions. However, this was not done. The vain effort to stabilise the new ratio was abandoned in September, 1920, and the two shilling rupee has since been a legal fiction. Left free from administrative action, the rupee fell below one shilling and threepence sterling and one shilling gold in 1921. Since, under the influence of good harvests, it has climbed upwards, and has been in the neighbourhood of one shilling and sixpence gold for the past twelve months. But it is not always realised in London that under these vicissitudes the Indian standard has legally perished. In the words of the report, " The stability of " the gold value of the rupee is thus based upon nothing more " substantial than a policy of the Government, and at present " that policy can be found defined in no notification or under- " taking by the Government. It ~~can~~ be implied from the " acts of the Government in relation to the currency, and those " acts are subject to no statutory regulation or control."

The responsibility remitted to the Commission was not therefore the mere stabilisation of the rupee, but the establishment of a standard which would command reasoned confidence in India, to link the rupee to that standard, and to provide for its statutory control, automatic working and stability ; to bring the control of currency and of credit under a single authority, and to free the Indian currency and exchange system from the dominance of the silver market. In short, it was to establish the rule of law in place of the practice of administrative discretion.

II.—SCHEME FOR A GOLD CURRENCY.

In the course of their inquiries in India the Commission had placed before them a scheme for the immediate establishment of a gold bullion standard, and its early conversion into the gold standard supported by the gold currency which a large body of Indian opinion has insistently demanded. The scheme was presented by the officials of the Finance Department, but it is known to be the work of the Finance Member, Sir Basil Blackett, whose work in India is of the greatest value.

The essential features of this scheme were the undertaking of a statutory obligation by Government to buy and sell gold bullion in 400 oz. bars ; as soon as sufficient gold was available to put a gold coin in circulation ; after a period tentatively fixed at five years to undertake to give gold coin in exchange for notes and rupees, and after a further period, also tentatively fixed at five years, to make the silver rupee legal tender only for sums up to a small fixed amount. The scheme involved the disposal of 200 crores of silver rupees, or 687 million fine ounces, in ten years ; the acquisition in all of £103 millions of gold ; and the establishment of credits in London or New York. The cost was estimated at one and two-thirds crores of rupees per annum during the first five years and thereafter from two-thirds of a crore to 1.12 crore.

This scheme is subjected by the Commission to a detailed examination, and rejected on grounds which are convincing. The main grounds for this decision are that the estimates of the amount and time of the gold demand are uncertain, and the absorption by India of this £103 millions of gold, in addition to the normal absorption for the arts, hoards, etc., would powerfully react on the supplies of credit, the rates of interest, and gold prices throughout the world. The reaction on the silver market from the dethronement of the rupee and realisation of this large quantity of silver bullion would be even more marked, with severely prejudicial effects on the silver hoards of the people of India, and the exchanges with China, where India still does a large business. Moreover, the capacity to raise the required credits is doubtful, and the cost is placed by the India Office at Rs. 3 crores a year.

The evidence of the highest financial authorities in London and New York established beyond doubt that it is not in the interests of India to precipitate any currency reform that would violently disturb the gold and silver markets, however desirable that reform might be in itself. Also, that whilst London, working in close harmony with New York, would strain every nerve to supply India with the funds she might require for her own development, it could hardly be expected to provide credits for a scheme which would upset the gold and silver markets. But whilst on these grounds the Commission were not able to endorse Sir Basil Blackett's scheme, there is no doubt that they were profoundly influenced by it in their own recommendations. The ultimate evolution of a policy which promises a cure for India's currency ills is therefore in large measure due to the courage and resolution with which the Finance Authorities in that country faced them.

III.—A GOLD BULLION STANDARD.

The currency system recommended by the Commission is a gold bullion standard. They propose that an obligation shall be imposed by statute on the currency authority to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee, but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold is required. The essence of this proposal is "that the ordinary medium of circulation in India should remain as at present the currency note and the silver rupee, and that the stability of the currency in terms of gold should be secured by making the currency directly convertible into gold for all purposes, but that gold should not circulate as money. It *must* not circulate at first, and it *need* not circulate ever." In breaking adrift from any idea of a sterling exchange, or gold exchange standard, the Commission were powerfully influenced by two factors—the necessity for safeguarding the Indian system from the price of silver rising above the melting point of the rupee and the desirability of establishing confidence by giving the country not only a real, but conspicuously visible link between the currency and gold.

This reasoning is eminently sound, and the scheme in its broad outlines should command the unhesitating support not only of India, but of all interested in Indian trade. India will have nothing to do with any exchange standard ; its experience has been too painful. Proposals to that end would be rejected by the legislature and prolong the currency controversies it is desired to close. The gold bullion standard satisfies all the country's real needs. True, it will not give it the gold mint and the gold currency which have long been demanded ; it involves the demonetisation of the sovereign to which a sentimental influence attaches. But whilst it does not do these things, it keeps the door open. No one contends that a gold standard and a gold currency are immediately practicable. The most rapid progress thereto is embodied in Sir Basil Blackett's scheme, which is full of uncertainties and risks. But when the gold reserves are strengthened to the requisite point, the proposals leave India perfectly free to decide, through her legislature, whether a gold currency is worth the expense. Personally I have little doubt that when confidence in the gold bullion standard is firmly established, India, with a free voice in deciding, will find that a gold currency is not worth the expense and risk involved, and is not necessary.

We must, however, face the obligation which a gold bullion standard imposes on the currency authority in India ; indeed the Commission do not attempt to burke it. " The obligation " is to convert the currency, not merely into foreign exchange, " but into metallic gold, and it is an obligation that is not, as " formerly, conditional and circumscribed, but absolute and " unlimited. Nevertheless . . . it has been undertaken by " every other country that has adopted an effective gold " standard : and we have satisfied ourselves that the present " resources in the form of reserves at the disposal of the " Government of India are adequate to enable the currency " authority safely to undertake the obligation, with the " measures of fortification, and at the time, which we specify." It is important, therefore, to examine the reserves and the procedure thereanent.

The reserves held for the purposes of maintaining the value of the token currency are two-fold—the Paper Currency

Reserve and the Gold Standard Reserve. Their constitution on April 30, 1926 (the date taken by the Commission), was as follows :—

PAPER CURRENCY RESERVE.

	Rs. crores.
Silver coin	77.0
Silver bullion	7.7
Gold coin and bullion	22.3
Rupee securities	57.1
Sterling securities	21.0
	<hr/>
	185.1

(The gold coin and bullion and the sterling securities are converted at the legal fiction ratio of two shillings per rupee.)

The Gold Standard Reserve amounts at present to £40,000,000, invested in British Treasury Bills and other sterling securities.

In theory the two reserves fulfil entirely different functions. The Paper Currency Reserve is the backing for the Note Issue. The Gold Standard Reserve, accumulated from the profits on coining, is designed to maintain the external value of the rupee. In practice their action is closely interlocked, and the first line of defence in the event of a demand for remittance from India is the gold in the paper currency reserve. This invisible line of demarcation will disappear if the Commission's proposals are adopted. The Commission are justified in recommending that the two shall be amalgamated. Their further proposals are that the proportions and composition of the combined Reserve should be fixed by statute; that gold and gold securities should form not less than 40 per cent. of the whole, with 50 to 60 per cent. as the ideal; and that the holding of gold, which now stands at about 12.8 per cent., should be raised to 20 per cent. as soon as possible, and to 25 per cent. in ten years. Generally, they are of opinion that during this period no favourable opportunity of fortifying the gold holding in the Reserve should be allowed to escape.

The proposal to bring the combined Reserve under statutory control is wise; an arguable case could be made out for the thesis that the currency difficulties of India have arisen in

the main from the decision of Lord Curzon's Government not to invest the official acceptance of the Fowler Report with legislative authority. The strengthening of the gold reserves is in entire accord with Indian needs.

IV.—THE RATIO.

The majority of the Commission, Sir Purshottamdas Thakordas being the only dissentient, recommend that the rupee be stabilised in relation to gold at a rate corresponding to an exchange rate of one shilling and sixpence to the rupee. Round this point controversy in India will be concentrated; it is worth while to refresh our memories of the history of the ratio. The Fowler Committee recommended that the rupee should be permanently stabilised at one shilling and fourpence; the Secretary of State for India accepted their recommendations without qualification. The rupee was substantially steady at this point until August, 1917.

One principle advanced in Sir Dadabha Dalal's prophetic minority report in 1919, that the legal standard of money payments should be, and usually is, regarded as less open to repeal or modification than any other legislative Act, will command general acceptance. But when Sir Dadabha went on to suggest that the Government of India might have avoided this measure by larger borrowings in India and encouraging investment abroad he was on ground where no one in touch with Indian conditions can follow him. In the circumstances of the day the Government had no alternative to raising the rate of exchange save in declaring the rupee inconvertible, which during the war would have been disastrous. I must reiterate the belief that the real mischief was done not when the rate of exchange was raised to meet the rise in silver, but when it was not lowered as silver fell; the attempt to stabilise the rupee at the two shilling rate caused the Government of India large losses, and inflicted a terrible blow on trade; after it was abandoned in September, 1920, the rupee fell below one shilling and threepence sterling and one shilling gold. Thereafter, under the influence of a succession of abundant harvests, it recovered. In 1923, it was one shilling

September, 1926.

and fourpence sterling ; in October, 1924, one and sixpence sterling and one and four gold. With the rise in the pound to gold parity, the rupee reached one and sixpence gold in June, 1925, and has remained there.

It is not, I think, open to doubt that if the vain attempt to stabilise the rupee at two shillings had not been made in 1920, or if advantage had been taken of its return to one and four, the permanent standard might have been re-established without undue disturbance. Sir Purshottamdas Thakordas asserts in his minute of dissent that " the Executive had made up their " minds to work up to a one shilling and sixpence ratio long " before this Commission was appointed to examine the " question. Indeed, they have presented to us the issue in " this regard as a *fait accompli*, achieved by them, not having " hesitated by manipulation to keep up the rate even while " we were in session. I cannot conceive of any parallel to " such a procedure in any country."

It is to my mind a great misfortune that the opportunity of restoring the permanent ratio of one and four was not seized when it offered. Not because there is any special sanctity in a ratio as such, but because there is a sanctity in the legal standard of money payments. If this had been done the Commission's scheme would have received practically unanimous support in India ; as it is a violent controversy will rage round this secondary issue, obscuring the great merit of the Commission's basic recommendation—a true gold standard, statutory in its composition and automatic in action, with the coalescence of the currency and credit authorities. However, we have to deal with facts as we find them. The majority of the Commission base their recommendation on the " convic- " tion, which has been formed and cumulatively reinforced " during the progress of our inquiry, that at the present " exchange rate of about one shilling and sixpence, prices in " India have already attained a substantial measure of adjust- " ment with those in the world at large, and, as a corollary, " that any change in the rate would mean a difficult period of " readjustment, involving widespread economic disturbance, " which it is most desirable in the interests of the people to

“ avoid, and which would in the end be followed by no countervailing advantage.” Sir Purshottamdas Thakordas, in a closely-reasoned minute of dissent, supported by a wealth of figures, avers—and to my mind with conclusive force—that the adjustments are far from complete, and cannot be completed in regard to wages without disastrous labour disputes. Both sides admit that their conclusions are weakened by the unreliability of the Indian index figures.

The truth, I suggest, lies between these two contentions. There have been very substantial adjustments to one shilling and sixpence ; no ratio could be operative for over a year without inducing this result. But it is clear that the adjustments, especially in regard to wages in Western India, are not complete. In the matter of the indebtedness of the agricultural classes of India—seventy per cent. of the whole population—there has been no adjustment, nor in relation to the land revenue they pay to Government. The ratio therefore cannot be determined as a question of academic principle, but is a matter of expediency.

Here, it seems to me, the decisive factor is the economic consequence of a return to one shilling and fourpence. There is no half-way house ; the rate must be either the *de facto* one of one and sixpence, or the old permanent ratio of one and fourpence. The change would be immediate—not a matter of weeks or months, but of hours or minutes. There would be an immediate rise in prices of twelve and a half per cent., with a consequent reduction of real wages by that proportion ; there would be convulsive disturbance of the foreign trade ; there would be violent speculation. I omit all calculation of the effect of the lower rate on the finances of the Government of India, because this is an influence which has been overvalued in the past ; it is infinitesimal in comparison with the industrial and commercial interests involved. No one who realises the sensitiveness of the Indian market, and the proneness to speculation, can contemplate these violent disturbances without a feeling akin to dismay. The balance of advantage lies with stabilisation at one and six ; the controversy which must ensue is part of the price to be paid for the neglect to re-establish the permanent ratio when it was practicable.

V.—THE CURRENCY AUTHORITY.

A feature in the Indian currency system little appreciated in Great Britain is the predominance of the Government. The Commission lay special stress on the disabilities this entails. "India is perhaps the only country, among the great trading countries of the world, in which the Government exercises direct control over currency in general and over the note issue in particular. The banking and currency reserves of the country are thus separated. . . . The Government controls the currency. The credit situation is controlled, as far as it is controlled at all, by the Imperial Bank."

A volume might be written on this subject, and on the controversy, the prejudice, and political harm which it involved. However, there is no useful purpose to be served by raking amongst these ashes, though the curious will find much food for thought in the historical retrospect, drawn entirely from official sources, which forms the first part of Sir Purshotamdas Thakordas's minute of dissent. The Commission propose to establish harmony between these hitherto diverse interests—though there has been a close working arrangement between the Government and the Imperial Bank of recent years, and the Government has developed the note issue with skill and enterprise—by the establishment of a new Reserve Bank. A detailed scheme for the constitution and working of the Bank, understood to be the handiwork of Sir Henry Strakosch, is embodied in the Report. The Reserve Bank, with a capital of five crores of rupees, is to have the sole right of the Note Issue; the responsibility for maintaining the stability of the currency; the custody of the cash balances of the Government and the duty of carrying through its remittances; it is to act generally as a bank of the banks, and its principal function will be to re-discount bankable bills held by the commercial banks. Subject to the payment of limited dividends and the building up of suitable reserve funds, the balance of the profits is to be paid over to the Government. In return for making over the note issue and the reserves, the Government is to nominate the managing-governor and deputy

managing-governor, and three members of the Board—five members from a Board of fourteen. In order to free the Bank from political pressure, the Commission think it desirable to provide that no person shall be appointed President or Vice-President of a Local Board, or shall be nominated as a member of the Central Board, if he is a member of any of the legislatures.

The main principle underlying this recommendation is not open to question. It is of paramount importance to remove the Indian currency system from official management and to link the control of currency with the control of credit. This connotes the establishment of a Central Bank. But it is not the complete essential ; far from it.

India is sometimes spoken of as the sink for the precious metals. So long as she chiefly absorbed silver the West looked on with benevolent approval ; now she is turning to gold the attitude is different. Indian capital is sometimes described as inadequate and timid. But critics do not realise that the banking organisation of the country is so hopelessly inadequate that hundreds of millions of people have no secure refuge for their store of value other than gold and silver bullion in their own possession. The Exchange Bank cling to the seaports. The indigenous banks follow their example. The Imperial Bank is the only organisation which can carry reliable credit facilities into the mofussil. The old Presidency Banks were lamentably slow in exercising this responsibility. The pace has been quickened, and as the price of the free use of the Government balances the Imperial Bank was called upon to open a hundred new branches. The total number of its branches is yet only a hundred and sixty-four, and it was stated by a competent banking authority in evidence before the Commission that India needed at least five thousand.

This extension of banking facilities is of transcendental importance. In an address to the University of Delhi last year Sir Basil Blackett committed himself to a remarkable statement. " To some it may sound fantastic, in view of this " historic habit—reliance on external capital—to talk of India's " not only supplying the whole of her own capital requirements

“ but also becoming a lender of capital for the development
“ of other countries. Yet, I believe firmly that, given the
“ necessary development of banking and credit facilities and
“ goodwill and readiness to profit by the counsel and assistance
“ of European business men, the time is not very far distant
“ when India will be doing both these things. India would
“ seem by nature to be destined to be a creditor country, if
“ only her people will it so.” But Indian resources will not
be mobilised without the vehement development of branch
banks.

As matters stand this work can only be done by the Imperial Bank, and though it is moving it is with desperate slowness. There are one or two features common to most of the hundred new branches it has opened. They attract deposits ; they facilitate the investment habit ; but they do not pay. To many who are in close touch with Indian conditions it seems that any measure which would weaken the capacity of the Imperial Bank to prosecute this unremunerative, but imperatively necessary, work by the diversion of the Government balances to the Indian Reserve Bank, or the division of these balances between the two banks, would be a retrograde measure. There are other considerations. The amount of re-discounting to be done in India is not large, as the Exchange Banks, which finance the export trade, re-discount in London, which is always likely to be the cheaper market. The number of men in India qualified to act on the directorate of banks is small. Are there enough to constitute reliable directorates for two great banking institutions? The Commission rather gloze over these difficulties. They think that the Reserve Bank will be able to spare for the Imperial Bank sufficient funds from the Government balances to enable it to prosecute the work of opening new branches ; also that a bill market will rapidly develop. But their arguments wear an aspect of special pleading. However, the issue can be put in a nutshell. India must have a Central Bank. If it is found impossible to develop, even as a temporary measure, the Imperial Bank into a Central Bank, then there must be a Reserve Bank on the lines sketched in the Report. But if a new Reserve Bank is established, it

is essential that provision shall be made for the Imperial Bank to enjoy the free use of a sufficient share of the Government balances to enable it vigorously to develop banking facilities in the moffussil, and this obligation should be made compulsory.

VI.—THE NOTE ISSUE.

Before the war there was a considerable and growing circulation of sovereigns. On the outbreak of hostilities these disappeared as currency; the actual currency of India is a token, the silver rupee, and another token, the note convertible into rupees. Ever since the breakaway from the accepted gold standard this obligation has imposed serious difficulties on the currency. It drove it into the very heavy coining which followed recovery from the famine of 1899-1900; it compelled heavy purchases of silver, which invariably rose in price as the Government came into the market; and it placed the Indian currency system, as occurred during the war, at the mercy of the silver market. The maintenance of the convertibility of the note into silver rupees of the present fineness is only possible so long as silver does not rise above 48*d.* an ounce. The removal of this anomalous provision, the Commission say, is an essential step in Indian currency reform which must be taken sooner or later. "No opportunity for the termination of "this obligatory convertibility is likely to be so favourable "as the present, when, by making the notes convertible into "gold bars for all purposes, a more solid right of convertibility "is attached to them than they have ever had since silver "ceased to be a reliable standard of value." Both propositions can be accepted in their entirety.

The rise in the volume of the paper currency is one of the most remarkable features in Indian financial history. It developed from no change in the status of the note itself; it was always convertible on demand; but from increased facilities for the encashment of notes, beginning with the introduction of universal notes of small denomination and steadily progressing as experience was gained. We can therefore endorse the conclusion of the Commission that the best way to foster the use of currency notes is to establish confidence in their practical

convertibility, " and this confidence has been secured not so much by a legal obligation to encash them at currency offices " as by making rupees readily available to the public at centres " where there is a demand for them." There has been another factor in popularising the note which commands less attention. The rise in prices made the rupee an unsuitable medium for large commercial transactions, from the bulk and weight of the amount of currency required.

The Commission therefore propose that whilst the legal obligation to convert into rupees all the notes in circulation shall remain, this obligation should not attach to the new notes to be issued by the Central Bank, and coincidentally the one-rupee note, which had acquired great popularity before it was discontinued on the ground of economy, shall be re-issued. The legal obligation on the Central Bank will be to give legal tender money, either notes of smaller denominations or silver rupees, at its option ; but it will be the duty of the Bank to supply rupees freely in such quantities as may be required for circulation, and of the Government to furnish the Bank with such coin. The currency position is such that the change in the legal status of the note will be unfelt. India is suffering from a surfeit of rupees, the total volume of which is estimated at approximately Rs. 400 crores. There are Rs. 85 crores of silver coin and bullion in reserve. The whole tendency will be in the direction of a return of rupees to the reserve rather than to an appetite therefor. Not only will there exist the fullest capacity to supply rupees on demand, but there will be a positive inducement to the currency authority to encourage a demand for rupees in order to get rid of its redundant stock. It is clear that the present opportunity of freeing the currency authority from the dependence on the silver market which has hampered India for so many years is exceptionally favourable, and should be seized without hesitation.

VII.—CONCLUSIONS.

Harking back to our original thesis, the responsibility remitted to the Commission, in fact if not in the actual terms of reference, was to establish a standard which would command

reasoned confidence in India, to link the rupee to that standard and to provide for its statutory control, automatic working and stability ; to bring the control of currency and credit under a single authority ; and to free the Indian currency and exchange system from the dominance of the silver market. They have discharged this responsibility with a skill and knowledge which merit our grateful thanks, and which make their report the most important chapter in Indian currency history since the work of the Fowler Committee. The gold bullion standard is the best possible standard for India ; it does not connote a gold mint and a gold currency, but neither is immediately desirable nor practicable ; if at any future time either or both should be needed, it opens the door to their adoption. The one and sixpenny rupee involves a breach with the permanent ratio, and a disturbance of the long established legal standard of money payments, which I for one profoundly regret, but at the same time recognise that in the conditions which exist a return to that standard would cause convulsions of the most lamentable character. The unification of the control of currency and credit under a single institution, and that independent of Government and political influences, is a measure of the first importance ; whether the institution be a new Reserve Bank or a modified Imperial Bank is a secondary matter. The rescue of the currency system from the domination of the silver market is a wise and necessary step. Above all, the scheme of this Commission, which places it on a plane far above all other inquiries into the Indian system, is that it goes right down to basic forces, and proposes to give the currency the authority of law instead of leaving it at the mercy of administrative discretion, which be it exercised never so wisely cannot inspire the public confidence which is the ichor of stability. As such, the Report of the Commission merits general acceptance, and it will be a tragedy for India if its outstanding advantages are obscured by controversy over the ratio or the actual constitution of the Central Bank.

LONDON MERCHANT BANK.—A dividend of 2 per cent. (less income-tax) has been declared on the ordinary " B " shares for the period of six months ended June 30 last.

September, 1926.

REPORT OF THE ROYAL COMMISSION ON INDIAN CURRENCY
AND FINANCE, 1926.*

By SIR JAMES B. BRUNYATE, K.C.S.I., C.I.E.

Paper read before the Royal Society of Arts on 12.11.1926.

INTRODUCTORY.

The appointment of the Royal Commission on Indian Currency in August, 1925, came at a specially interesting moment in India's monetary evolution. She had just completed a cycle of currency experience. The pre-war gold exchange standard, instituted in 1899, broke down during the war as the result of rising silver prices, and a premature effort to restore it on a 2s. basis in 1920 failed. A stage followed in which the value of the rupee bore no fixed relation to that of gold. India had returned to the conditions obtaining after the voluntary abandonment of the silver standard in 1893. After a like interval—five or six years in each case—the moment for an effort at permanent stabilisation had obviously arrived, and also for fresh constructive work of the most important kind. In this respect the Hilton Young Commission ranks with the Herschell and Fowler Committees. The task of the two earlier Committees was the pioneer work of establishing a gold or gold exchange standard under wholly untried conditions: that of the last Commission to give India a modernised system which should embody the lessons of the drastic monetary experience through which the world has been passing in the last twelve years. This Commission, moreover, had to deal with a politically new India. It is not without significance that it should be the first to visit India, and the first to include in its personnel a large proportion of Indians.

*Cmd. 2687.

The Commission have fully realised the scope of their task; have attacked their subject scientifically; and have produced a report which seems to me a notable example of clearness and unity of purpose. They claim, indeed, (paragraph 167) that their various proposals are so strictly interdependent that their scheme should be accepted as a whole. This claim, if not maintainable to the letter, is at any rate, very largely true. For this reason I have felt special hesitation in offering criticism of individual proposals. I refer particularly to the proposal to take away at an early date the legal right of converting notes into rupees and the proposal to sell gold bullion in India. I shall have to examine these rather fully. For the rest I find myself in general agreement with the Commission's scheme, and I have nothing but admiration for that branch of it which deals with the methods and machinery of control—the most distinctive and valuable contribution, I think, which any Commission has yet made to India's monetary problem.

My admiration for the report as a document is more tempered. I find something needlessly slighting in the general tone of the Commission's references to the pre-war system. There is some extravagance, too, in the Commission's frequent insistence on the special intelligibility and confidence-winning properties of their own scheme. Sir Fasil Blackett stated in evidence (Qn. 451) that he attached "great importance to confidence on the part of the public in their currency and also to the currency system being one which is comparatively easily intelligible to them." These maxims are very opposite to the defence of a gold currency scheme. A gold currency would indeed be "conspicuously visible" and in a sense "intelligible to the uninstructed" (paras. 61 and 30-32). But they become mere *clichés* when extended to the Commission's complex scheme. I do not wish to dwell on such points, but they cannot be left quite unnoticed. The conviction that the pre-war system must be ended and not mended, and the illusion, as I regard it, that the advantages peculiar to a gold currency can be otherwise secured, have

THE PRE-WAR CURRENCY SYSTEM.

So much by way of introduction. To enable you to appreciate the significance of the new scheme, I must give you some account of the pre-war system. As you all know, I expect, it has been fully described, with insight and evident access to all relevant material, by Mr. J. M. Keynes in his book on "Indian Currency and Finance." The system owed its inception to the courage and vision of two men, Sir David Earbourn and the late Mr. A. M. Lindsay, who staked their reputations, the one on the closing of the Mints and the other on the practicability of a gold exchange standard. Among the body of men, mostly civil servants, who were concerned in its development, the most remarkable and the chief shaping influence was the late Sir Lionel Abrahams of the India Office: that acute and dominating personality who during twenty years watched over the monetary system of India with tireless interest and never-failing resourcefulness.

As finally developed, it established in India that type of the gold standard which is known as a gold exchange standard. Exchange was restrained from rising above upper gold point by the Government of India's readiness to receive gold in India at par, and eventually, in ordinary practice, by a standing undertaking of the Secretary of State in Council to sell Council Bills without limit at Rs. 4½d. It was restrained from falling below the lower gold point by the sale of sterling drafts on London, whenever a serious weakness of exchange became manifest. This procedure was only instituted after a rather serious hesitation in supporting exchange during the American crisis of 1907, and its scope was never precisely defined. I think it is accurate to say that with the issue of the Chamberlain Committee's report in the spring of 1914 the Government had reached the point that they were ready to pledge themselves publicly to support exchange "to the full extent of their resources" (and indeed, did so in August, 1914), but were not yet prepared to offer more than a stated amount of sterling drafts weekly. Throughout the whole pre-war period the Government were issuing sovereigns to the public, originally in pursuance of the Fowler Committee's instruction to aim at a gold currency in India, and later through reluctance to interfere decisively with a valued privilege. Policy in this matter had become, I think, rather vacillating and undefined. I may add, finally, that the system was wholly bureaucratic in administration. The administration was efficient because it included in its scope only those functions which a bureaucracy was capable of discharging efficiently. It depended on its reserves, and not at all on any deliberate policy of credit control. Its merits and defects were summarised in the two sentences with which, writing as long ago as 1913, Mr. Keynes closes his book on Indian currency. The first is an appreciation of what we did; the second a pregnant summary of what we failed to do and a remarkable anticipation of much that is now written large in the recent Commission's report, but with added emphasis from post-war experience, Mr. Keynes wrote:—

"In the Gold Exchange Standard, and in the mechanism by which this is supported, India, so far from being anomalous, is in the forefront of monetary progress. But in her banking arrangements, in the management of her note issue, and in the relations of her Government to the Money Market she is anomalous; and she has much to learn from what is done elsewhere."

Amplifying this a little, I think the pre-war system may claim to have established the gold exchange standard as a practicable and acknowledged variety of gold standard. It built up from nothing a great reserve of gold and gold securities (now £80 millions) and fostered an amazing growth of the note circulation. Without these the present Commission would have had no sovereign has possessed since 1899.

The question of the ratio is more difficult. There is some important opinion

foundation at all on which to build. The same school of finance, in January, 1921, achieved the unification of the Presidency Banks. It was hoped that this would prepare the way for the establishment of a State Bank later on; it may, I am afraid, turn out to be an obstacle. Above all, the system kept exchange steady. Its principal faults will be apparent from what I have already said. It sought no assistance from banking agency. It had no clear policy in regard to gold. And its procedure for supporting exchange, though effective in practice, was not technically complete. I shall bring out some of these points more fully at a later stage. These defects were mainly traceable to special conditions which could not be readily corrected, such as the anomalous status of the rupee; the originally undeveloped state of the paper currency; the initial want of gold reserves; and the absence of vertical banking organisation. Moreover, general currency theory and practice were still in 1899 somewhat confused and uncertain. Since that date, as the Commission tell us (paragraph 224), they "have undergone a steady process of evolution." The pre-war system was pioneer work. We may say of it, I think, that it was effective and not unprogressive; and further that it has been an indispensable link between the silver standard of the old days and the highly modern system for which India is now considered to be ripe.

To its monetary shortcomings we must add a growing unsuitability to India's changing political conditions. I do not suggest that political sentiment has anything at all to do with the question whether the rupee should be fixed at 1.6 or 1.4; or that it can be a decisive factor in determining whether India should or should not have a gold currency. But some aspects of monetary constitution-making are unquestionably political or constitutional. We can all see that once India started on the road to self-government and the party system it became inevitable that sooner or later the management of the currency system should be taken out of government hands. We have here a decisive constitutional factor. I think, too, that it was a natural political instinct which demanded for India a normal gold standard, and not some system which seemed to be devised exclusively for herself. She dislikes being treated as a backward country, or being attached, as she supposes, in a special and subordinate relation to London and London interests. Give her the same system and the same institutions as the advanced countries of the West and you dispel finally an agitating obsession. With the Central Banking system, of which leaders of Indian opinion have hardly heard hitherto except as a phrase, she gets an additional and unlooked-for status, that of partnership with other countries, through their Central Banks, in the general monetary regulation of the world. I think that with this attainment of her real ends, the cry for a gold currency will tend to die down. It was demanded mainly because the Fowler Committee and our official class for many years after had taught that without a gold currency there could not be a genuine and normal gold standard. This, as Sir Basil Blackett observed in his evidence, is now regarded as a "Victorian" view.

THE COMMISSION'S PROPOSALS.

I now turn to the Commission's proposals. There are two major decisions which I do not intend to examine seriously to-night. Each would well take a paper to itself. I refer to the Commission's rejection of the gold currency scheme put forward by the financial authorities in India and to their support of the 1s. 6d. rupee. The case against the Blackett scheme is convincingly set out in the Report. It is a remarkable fact that not a single member of this very representative Commission has felt able to recommend it. Indeed, the Commission are so decisively opposed to the use of gold in circulation in India that they advise the withdrawal of the legal tender quality which the sovereign has possessed since 1899.

The question of the ratio is more difficult. There is some important opinion

give me fairly strong evidence that prices are now substantially adjusted to the 1s. 6d. rate. Far the weightiest point is that 1s. 6d. is the rate in being. I do not myself doubt that, on many practical grounds, the Commission are right in their decision to stereotype the attained rate without longer waiting, though I feel respect for the arguments on the other side.

To discuss these points further would take me away from my main purpose to-night, and I proceed at once to the Commission's own scheme, which I shall deal with in three sections:—

- (a) The domestic side, *i.e.*, the internal stability of the rupee.
- (b) The foreign exchange side, *i.e.*, the external stability of the rupee.
- (c) The controlling and correcting mechanism.

(A) INTERNAL STABILITY OF THE RUPEE.

You will need no explanation from me as to what I mean by the foreign exchange side. India's domestic monetary problem is, however, peculiar to herself and needs some elaboration. Essentially it is "the problem of the rupee," as I may call it.

The mass of Indians, though universally aware that the rupee passes from hand to hand as worth much more than the silver contained in it, have long been content to accept it much as if its value in exchange were an absolute value not needing extraneous support; and consequently have also accepted it as a valid and sufficient backing to the paper currency. They have trusted the promise of the Government that notes will be freely exchangeable into metallic rupees and have asked for no further promise. The Commission, however, insist that the coined rupee is itself only a note - "a note printed on silver" - and that if the paper token currency needs a backing so does this peculiar metallic token currency. And they imply throughout that the earlier confidence of the masses in the rupee has begun to be shaken and that on practical as well as theoretical grounds some new and visible basis for notes and rupees must be found. That basis can of course only be gold, and as the idea of a gold currency is rejected the gold can only be bullion.

Further, the Commission have technical grounds of complaint against the metallic rupee. I have only time to sketch them briefly, but they undoubtedly constitute an impressive indictment. The rupee is costly to provide and the seasonal demand difficult to measure. An immense accumulation of redundant rupees is apt to pile up in our reserves in the lean years which so often follow a spell of prosperity. We have Rs. 100 crores in reserve now which the public may not re-absorb for an indefinite period, if ever. The return of hoarded rupees into active circulation is an impediment to credit control. Reliance on metallic currency *pro tanto* restricts the scope for an elastic currency, and so further prejudices credit control. The necessity for providing for rupees as well as gold in the Central Bank reserves will complicate their procedure and make it less generally intelligible. Finally, there is always the possibility, though it is exceedingly remote, that with soaring silver prices, a rise in the intrinsic value of the rupee may again break down the standard, or force the Government into inconvertibility. Following this train of thought, the Commission are led to the conclusion that the "dethronement" of the rupee, that is the eventual limitation of its use to small change transactions, must be made a recognised objective of Indian monetary policy. They totally reject, however, all violent means to that end, such as were propounded in the gold currency scheme. "Dethronement," therefore, if it can be brought about at all, must be the outcome of the existing natural tendency to move away from rupees to notes, fostered by any legitimate means of further popularizing the note issue. From this standpoint, too, the Commission see great advantage in conferring on the note issue the quality of convertibility into gold bullion.

SIR JAMES BRUNYATE'S PAPER ON THE INDIAN CURRENCY
COMMISSION'S REPORT.

The attached matter will be substituted for the bottom paragraph on page 3 of the proof, and the top paragraph on page 4.

Finally, as regards redundant rupees. I think we shall have trouble in the future from this question if only from the existing tendency for gold to replace rupees in hoards, and more, of course, if the Commission's gold convertibility scheme is the success that they anticipate. It is no use deprecating this for it comes in the natural course and must be dealt with when it comes. The Commission, however, might have told us more clearly how they expect the Government to dispose of the rupee stocks for which they are to be made responsible, or to finance the carrying of them if they cannot dispose of them.

If, as the Commission require (paragraphs 121-2), the Government are to finance the withdrawal of rupees with only fractional assistance from existing monetary assets, they will be forced into one of two courses: either extensive silver sales without regard to the state of the silver market, or extensive borrowing without regard to the possible adequacy of India's monetary resources as a whole. There is quite a fair probability that under the Commission's proposals the Government may find themselves compelled, in the next five years, to borrow something like £20 million, merely to enable the Bank to keep its gold assets of about £80 million practically untouched. I suggest that this imposition on the Government of a peculiar responsibility for one arbitrarily detached element in the monetary system is wrong. The authority which takes over the monetary assets as a whole, should also shoulder the admitted monetary obligations as a whole, including the obligation to redeem rupees. If it cannot both do this and undertake a new commitment such as the supply of gold for internal use, it should refuse the new commitment.

The whole question is one of first rate practical importance in view of the actual rupee position to-day and the profound inexpediency* of reckless sales of silver. It is also one which organically affects the Commission scheme. With all respect I submit that it has not been sufficiently explored.

* Cf. On this point the Commission's own observations in paragraphs 46-50 and 53, last sub-paragraph.

I will not formally summarise this section of my survey. I respect sincerely the Commission's attempt upon the internal problem, as I have called it. The same kind of work done twenty-seven years ago, if it had been possible then, would have been an invaluable guide to administration. But in the specific proposals there seems much to question. I shall have to return in the next section to the question of gold sales in India. On the question of the rupee encashment of notes I have stated my view: but the point whether encashment should continue *de jure* as well as *de facto* is not quite of the first order. The problem of the redundant rupees is, I think, serious. It is not a problem of the Commission's making and it is impossible for them with a stroke of the pen to dispose of it. I want to see it tackled by the Bank rather than by the Government. But I recognise that the Government must stand behind the Bank. The Government have a residual responsibility for the monetary system as a whole, though not an immediate and, as it were, a personal* responsibility for surplus rupees in particular.

I have in mind the curious argument in the first sentence of paragraph 122.

We find then that the domestic problem is twofold, namely, how to inspire the masses of India with confidence in the value of the currency unit, and how to remove or mitigate the inconveniences attached to the silver rupee; and that the Commission's solution in both cases is the dethronement of the rupee; the backing of notes, and rupees so far as they are still used, by gold bullion; and, as a corollary, the eventual withdrawal of the right of converting notes into rupees. There is, of course, no intention to repudiate the existing Government note issue. The institution of a Central Bank necessitates its withdrawal in any case, and every note returned will be honoured in rupees if rupees are demanded. The new conditions will be applied to the new Central Bank issue which will replace the present notes.

The Commission's proposals are difficult to state precisely and the gold bullion proposal will require restatement from another point of view later on. A brief reference will suffice for two minor measures, namely, the re-introduction of the one rupee note, which should never have been abandoned, and an interesting suggestion, with some future possibilities in it, to issue savings certificates repayable on maturity in gold bullion. The main proposals may, for present purposes, be stated as follows:—(a) The new notes and rupees also are to be full legal tender and convertible on demand into bars of 400 oz. fine gold (value about £1,700) at par when exchange is at or above upper point, but otherwise, *i.e.*, normally, at a discount of about 2½% below parity. (b) The notes are not to be legally convertible into rupees but are to be freely encashed in practice "so long as the people desire to obtain metallic rupees in exchange for them" (paragraph 69). The Commission hazard the suggestion (paragraph 70) that the public will probably be ready for the withdrawal of the extra-legal facilities for encashment "before the present stock of rupees runs low." (c) On the assumption of a progressive decline in favour of the rupee they lay it down in their Central Banking Scheme that the rupees (over Rs. 80 crores on present figures) which the Central Bank is to take over into its Issue Department shall be reduced to Rs. 25 crores in ten years by issue to the public or by being "got rid of deliberately" (paragraph 135). (d) Certain complicated provisions (cf. paragraphs 122, 135, 145-7 and Schedule III) throw on Government as distinguished from the Central Bank an indefinite measure of responsibility for carrying or disposing of redundant rupees on the curious ground that "it was the Government that put them into circulation."

I think that the dethronement of the rupee is a right objective, if attainable by natural means. It is the appropriate sequel to the policy of popularising the note issue begun in 1910 and 1911 and immensely extended by the grant, in the late Sir Wm. Meyer's *régime*, of facilities for encashment at Treasuries generally. To these measures and the war we owe the almost fourfold increase of the active circulation since 1914. The crucial question is: can the Commission do better still in the way of making notes popular? The new attraction which they offer is the right of converting notes into gold on the terms stated. That privilege will apply equally to rupees. It will not be visible in the daily experience of Indian note users. It will not, even indirectly, make gold cheaper or obtainable by the small purchaser more freely or through any new agency. Even to the bullion dealer the mutual convertibility of money and gold bullion will not present itself as a point of monetary procedure, but as a sale, and a sale at a rather stiff price.

I think myself that at the best the Commission's proposed measures will leave the public generally quite uninterested. Their new notes, I think, will win their way, after some initial set back perhaps, through the old confidence in the Government, which is to guarantee them, and the discovery in experience that after all they are exchangeable into rupees in practice, whatever the Government say or omit to say on the face of them. I can see no reason why they should be *more* popular than the old notes and no reason therefore why the new terms should assist the note in its competition with

the rupee. No doubt this is a matter of individual judgment. Much depends on how far one is disposed to attribute to the masses in India positive monetary concepts as distinct from an ignorant readiness to be scared about money ; or an interest in gold bullion in bulk corresponding to their undoubted interest in gold bullion in little. A branch manager of one of our great banks was unable to tell me the other day the terms on which the Bank of England is obliged by law to supply bullion in this country. Even Sir Basil Blackett had to look the point up before giving evidence (Qn. 377). It is hard to believe that Indians at large are going to be any wiser in regard to gold issues in India. But whatever the popular effect of the commission's scheme of gold sales may ultimately be, it is premature at present, and I submit, wrong in principle, to withdraw the legal right of converting notes into rupees. It is admitted that full facilities for cashing notes must be given in practice for many years to come : the Legislature ought not to be asked to make a drastic change in the law without a responsible sense of its consequences in action. The objection of principle hinges on the fact that the rupee is to continue indefinitely to be full legal tender (par. 74). It may be variously expressed : One may put it, for example, as an admitted principle that the fundamentals of a paper currency system must be regulated by law. The extent of convertibility into other forms of full legal tender currency is certainly a fundamental, or, again, the Commission themselves would, I think, accept it as a principle, that a monetary obligation which must in practice be absolute should also be statutory. They invariably insist on this in dealing with the measures for supporting exchange. Rupees and notes, being both full legal tender, must be maintained at an identical value, which is not possible if the Bank is at liberty to refuse to give rupees for notes. The obligation of the Bank to give rupees, at some named centres at any rate, must be absolute, and being absolute ought to be statutory. It cannot be right that the Government, advised by the Bank itself, should be legally free to determine and vary the terms on which the Bank is to honour its own notes. I suggest, then, that until conditions are ripe for restricting the legal tender quality of the rupee the new note issue must be convertible into rupees both in law and in practice. If it ever becomes possible to make the rupee a subsidiary coin it will also be possible, though doubtless inconvenient, to recall the original and convertible Bank issue and replace it by a second and inconvertible issue.

As regards the menace of inflated silver prices I would like to add this. I am not inordinately afraid of an inconvertibility imposed on us by the course of silver prices, as was threatened in 1918. India learnt a good deal then and would understand the defence of *force majeure* when the time came. I am a good deal afraid of an inconvertibility which is the outcome of a premature commitment of policy and seeks support in the technical defence that the right of rupee encashment was long ago taken away by law, though never withdrawn or even progressively restricted in practice.

Finally, as regards redundant rupees. I think we shall have trouble in the future from this question if only from the existing tendency for notes to replace rupees : and more, of course, if the Commission's gold convertibility scheme is the success that they anticipate. It is no use deprecating that for it comes in the natural course and must be dealt with when it comes. Perhaps, however, the Commission might have told us more clearly how they expect the Government are to finance the carrying or disposal of the stocks for which they may ultimately find themselves responsible ; and I am a little puzzled as to whether in the main the Commission contemplate holding or selling. Again, I do not see why, as long as the " note printed upon silver " does remain predominant, it should not be a concern of the Central Bank's quite as much as the ordinary form of note. I feel rather strongly that the practical difficulties ahead could be better dealt with quietly by the Central Bank. and unqualified obligation. The limitation of owners' sterling to stated

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I need not, I think, sum up this section of my survey at any length. I suggest that action in the way of making notes inconvertible into rupees, or of laying down programmes for the progressive reduction of silver stocks is at present premature. I am sceptical as to the alleged distrust of the rupee: if it exists I think a continuous spell of price normality will soon cure it. I do not myself see how the gold bullion proposal can do much to relieve such distrust: and I do not see any need for selling gold for internal use on technical grounds. The sale of gold for export supported by the system of credit control which the Commission propose will of itself achieve internal stability, *i.e.*, steadiness of internal purchasing power, as similar measures already do in England. Here, too, gold is handled in 400 oz. bars, and though the law imposes no restriction on the purpose for which the gold is required, it is, in practice, taken for export only.

(B) EXTERNAL STABILITY OF THE RUPEE.

I deal next with the arrangements for maintaining the exchange value of the rupee. The Commission propose to stabilise it in terms of gold bullion at a point represented by the equation: Rs. 21 as 3 ps. 10 = 1 tola of fine gold, *i.e.*, it is to be maintained at a value equal to three-fortieths of the gold in a sovereign. Thus we may conveniently describe the new parity as: Rs. 1 = 1s. 6d. gold.

The Commission propose that the Central Bank shall be under obligation (a) to buy gold bars of the size already stated without limit when tendered in India; (b) to sell gold bars without limit for delivery in London*; and (c) to sell gold bars without limit for delivery in India. The buying rate will be par in all cases. That is in accordance with ordinary gold standard practice and also pre-war practice in India. The selling rate for delivery in London will be par plus a charge covering cost of shipment to London and loss of interest. This is in accordance with ordinary gold exchange standard practice and (*mutatis mutandis*) with pre-war practice in India. The operator who asks for delivery in India, and who is presumably, therefore, not an intending exporter, is to get the par rate only when exchange is at or above upper gold point and at all lower levels of exchange will pay an additional charge representing *twice* the shipping and interest charge. I will deal presently with this peculiar case.

* Except when exchange is at or above upper gold point (par. 150). The facility of gold in India at par will then be available. This transition from exchange methods to gold standard methods is more apparent than real, for at that level of exchange gold will not be wanted for export.

We may pause for a moment to consider what these proposals imply. I would suggest, *first*, that the two obligations, to buy in India at par, and to sell for delivery in London at the rate proposed, constitute together a complete basis for supporting the desired standard relation between the rupee and gold. The system will work as a monetary system by virtue of the sale of gold for delivery in London and not by the sales in India. *Secondly*, the standard, as the Commission rightly claim, is based on gold and not on sterling. If the two main undertakings can be made effective, India will possess a system as advanced as, and essentially similar to, those of gold standard countries such as Great Britain and the United States of America. This means efficiency, not of a rough and ready kind, but scientific and refined. It should also mean finality. The full establishment of the new system should close the agitation over India's monetary problem.

We may readily recognise the advance implied in an unqualified undertaking to sell gold for export. I think that the determination of Government to support exchange was generally appreciated even under the pre-war system. But this determination fell far short of the acceptance of a standing and unqualified obligation. The limitation of offers of sterling to "stated

ing supply, as actually happened in quite extraordinary circumstances in 1920, so that technically the Government's ultimate undertaking was rather to restore exchange, if it got temporarily out of hand, than continuously to maintain it. There was, too, an element of personal judgment in the system and a necessity for accommodating possibly divergent views in Whitehall and Simla which constituted a weakness.

I now return to the question of gold issues in India. We have examined it once as a matter affecting the convertibility of notes and rupees. It reappears now in association with the arrangements for maintaining the foreign exchange. If you read paragraph 150 of the Report you will find the question of gold sales for delivery in Bombay almost inextricably interlaced with that of sales for delivery in London, and an option between the two offered as if they were *quodam generis*, like, let us say, demand drafts and telegraphic transfers. That is not the case. Sales for delivery in London are intended to serve a monetary purpose and the rate which would be natural under a gold exchange standard will apply. Sales for delivery in Bombay are intended to serve a non-monetary purpose and a special and deterrent rate will apply.

The Commission justify by the most cogent arguments the necessity for a deterrent rate in the case of sales in India. The grant of parity terms would destroy the bullion market; make the Central Bank the sole source of supply for all the gold required in India for non-monetary purposes; and compel a very restrictive credit policy. The Commission have accordingly proposed rates which will make it cheaper at all levels of exchange below upper gold point to import gold from London than to acquire it from the Central Bank. In no case will importation be actually more expensive. Thus, though the internal demand itself is continuous, this special arrangement for satisfying it will normally be inoperative and is meant to be inoperative. In any case, the sales in India will not be the actual means by which the gold standard is supported. Considered from the foreign exchange side they appear to be not an integral feature of the scheme, but "exerescent and unnecessary," as the Commission quite justly say (paragraph 66) of our pre-war gold currency.

I have now examined the question of gold issues in India in its several aspects. This part of the procedure very much confuses the simple and sufficient lines of the Commission's main scheme. It is meant to be inoperative. And, as I previously said, I do not understand that any one regards it as technically necessary. I suppose it has a value as a kind of salvage from the wreck of the gold currency project. But the Central Bank is the true compensation for that. The question, happily, does not call for instant decision. It is not contemplated that the Central Bank shall undertake to sell gold till the 1st January, 1931, or issue notes till the 1st January, 1929 (paragraph 165). Meanwhile the rupee will be kept stable on the *ad interim* basis that the currency authority shall be under obligation to buy gold or to sell gold or gold exchange at its option at the gold points (para. 166). So simple is the statement of the really necessary things.

Before I leave the Foreign exchange side of our subject it may be useful to say something on the question of choice of standard; *i.e.*, the question of a gold standard versus a gold exchange standard. The term "gold exchange standard" has become a term of prejudice with a certain school of opinion in India, owing to its association with bureaucratic control of the currency, and the Commission seem anxious that this label should not be attached to any goods which they deliver. One seems to see that apprehension running all through their examination of the case for a gold exchange standard (paragraphs 26-32) and again in the emphatic claim (paragraph 60): "Since gold

will need to hold. This is the theme of the final branch of the Commission's

bars are to be given in exchange for notes or silver rupees, not for export only but for any purpose, this is not an exchange standard: it is an absolute gold standard." One might suppose that the two types of system were sharply antithetical, like white and black; or good and evil. On the contrary, with the disappearance of gold currencies, they have become sometimes very hard to distinguish. Indeed, I am not sure that theorists are agreed as to an absolute line of demarcation. Probably every system based on gold uses exchange methods largely. Every one recognises that they are efficient methods, and they seem likely in some shape to be the final methods of the future. You may have noticed that Professor Cannan (Qn. 13, 210) told the Commission that "when you get on to the bare bones of the gold exchange system there is very little difference between the two—some people say that this country is on a gold exchange standard system now." And the Governor of the Bank of England was, I take it, pleasantly saying much the same thing when in reply to a question (Qn. 13, 752) about "a simple gold standard," he observed: "I do not know what a simple gold standard is."

The fact that the Government in India controlled the currency was an accident of circumstances; that control will now disappear; and the necessary thing is to get away from labels and deal with questions of substance. Far the most important question of substance behind this issue is the question whether India, at considerable expense, should take her share in holding large stocks of the world's monetary gold, and so constitute herself one of the curators of the world's gold standard; or whether she should save herself that expense and depend by means of foreign credits on the gold holdings of external money centres. There is nothing derogatory or abnormal in such dependence for a country which cannot aspire to be one of the world's great money centres; and either way, India will have the same standard of value and full assurance of stability. The Commission favour the former course and recommend that the Central Bank be required (paragraphs 132 and 145) to keep a reserve of gold and gold securities equal to 40% of its liabilities and to work in practice to a much higher percentage. For gold, as distinguished from gold securities, an eventual minimum of 25% is prescribed, which even on present figures would mean £45 millions. In practice, I take it, all or almost all the work of the system will be done on exchange standard lines, but India, as a large and independent gold holder, will be one of the true standard bearers. If we are to look at essentials I think myself that this does not constitute a gold standard, but as I said before the question of the label is trivial. Personally I am in favour of the course recommended by the Commission, but there is something to be said on both sides. The Commission in their only formal examination of the subject (paragraph 26-32) leave the case to a great extent unstated and base their decision mainly on the question of confidence or want of confidence in a currency not supported by gold issues for internal purposes.

(C) THE CORRECTING MECHANISM.

I now come to the third and last section of this survey, in which I deal with the proposals regarding the correcting mechanism and the institution of a Central Bank. Let me begin it by correcting a possible misunderstanding of what I have already said. It would be the greatest mistake to look on this Commission as encouraging the wasteful use of gold. There are, as it seems to me, two principal motives running through their scheme. One is the basing of every part of India's monetary system upon gold, though the mere *jacade* of a gold currency is refused. The counter motive, which comes in at every point, is the perfecting of the adjusting mechanism. Every loss or acquisition of gold is to be accompanied by a corrective reaction. Gold is to be merely a balancing factor; and the more complete the success of the Commission's scheme the less the share of the world's gold which India

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say that they aim at a note issue as the primary circulating medium ; absolute guarantees as to the free inter-changeability of domestic currency and gold bullion ; with adequate reserves to enable the controlling authority to tide over temporary difficulty ; and, by way of correcting mechanism, a complete and modernised system of currency and credit control : the whole to be administered by a Central Bank detached from political interests ; secured from the day to day interference of the executive, but ultimately, of course, subordinate to the high policy of the State ; co-operating with Central Banking institutions elsewhere ; and kept in touch with normal business realities by the constitution of its Central Board and the interests and voice of its shareholders.

The perfection of the correcting mechanism is the unifying principle informing every part of this scheme. As we have already seen, the preference for a note currency instead of a metallic currency is largely due to this requirement ; also the choice of gold bullion in preference to gold coin. Again, it is only on the assumption of proper currency and credit control that it is possible to guarantee exchange unconditionally. We might no doubt have been tempted, under the pre-war system, as our reserves grew stronger, to accept wider obligations in regard to selling sterling—the question was apt to be of one controversy between the Government of India and the Secretary of State, but an unlimited obligation must have remained quite out of question as long as our correcting mechanism was inadequate, and no improvement of it was in sight. The same factor influences the size of the reserves. The better the correcting mechanism the less reason to rely on sheer weight of metal : expense is less and the demand on the world's available gold is less. Professor Cassel, indeed, in his book on " Money and Foreign Exchange after 1914," goes so far as to say that " No gold reserve in the world can guarantee the redeemability of a currency if a general parity with gold is not maintained through a proper discount policy." Finally, the choice of an advanced system of regulating currency and credit determines also the choice of controlling authority. Such work is specifically the function of a " Central Bank."

A monetary demand for gold from the controlling authority or a tender of gold to that authority is an indication of some departure from exchange equilibrium. The most elementary and obvious of the possible correctives is the requirement that the influx and efflux of gold should invariably be accompanied by a corresponding expansion or contraction of the currency. This effect was in fact produced under the pre-war system when the tender of gold was followed by the issue of rupees to the same value or conversely when the sale of sterling drafts on London was accompanied by the withdrawal of the equivalent amount of rupees from circulation and their deposit in one or other of our reserves. All this came to be fully recognised in India, and it was the conscious aim of the Government that in the system under their management the contraction and expansion of the currency should proceed exactly as it would under a gold standard with a gold currency, which the financial world of that time supposed to be the last word in automatic action. Admittedly, as I said earlier on, we had little support from discount policy, for the Banking conditions in India did not permit of it. But India was not alone in that.

It seems to me that the Commission's case against our pre-war adjusting procedure is really two-fold : *first*, that we did not strictly adhere even to our limited ideal of automatic action or non-interference ; *second*, that in any case a wider conception of the duties and opportunities of the controlling authority now obtains, and Indian practice should conform to it.

provided, again, that the use of this currency expands.

This, then, as I understand it, is the correcting mechanism on which the Commission lay such stress. The old ideal of automatic currency expansion

The first point is true in terms. It is one of much interest and I should have been glad to learn clearly how, if at all, the Government's normal handling of its remittances and its normal behaviour in respect of currency expansion and contraction generally, departed from sound monetary practice. The examples from war finance and the crisis of 1920 (paragraphs 16-17) or taken from the period subsequent to 1920 (p. 42, footnote) when the pre-war system had ceased to exist and the currency was admittedly being "managed" seem hardly representative. Allowing, however, that the pre-war ideal of automatic action was not fully realisable, the more important point is this: that the ideal itself has become obsolete.* Currency control to-day aims not so much at letting spontaneous monetary movements take their natural course as at an active and anticipating policy of regulating them, employing for the purpose every available Banking expedient. A striking example is the action of the Federal Reserve Board in the United States in preventing the large war and post-war accretions of gold in that country from producing their full natural effect on credit, which in the quite abnormal situation there could only have been disastrous. Thus, in a special case, the very first principle of the compensatory and corrective procedure has to be thrown over, automatic action being replaced by avowed management.

*Cf. W. J. M. Keynes: evidence: Qns. 12983-12987.

This contrast between the older idea of automatic action and the newer idea of management is very sharp. In Schedule I (p. 94) you will find the Commission envisaging such a possibility as the Central Bank's maintaining exchange permanently at upper gold point by a continuous policy of contracting credit. Of course, they admit this to be mischievous and they have proposed effective measures to make it unnecessary. But it illustrates the new conception of a controlling authority's scope and power. Without, however, pressing this extreme and hypothetical illustration let me quote to you some of the Commission's observations as to normal practice. They tell us (paragraph 22) that "an exaggerated idea" obtains in India as to the extent to which any system of currency can be made to work automatically and independently of expert control." They state (paragraph 217) that better statistical data are essential if the Reserve Bank is not to be "handicapped" "at its inception," thus pointing to action on the basis of price movements as one of a Central Bank's normal duties. They speak in paragraph 104 of the necessity "to co-operate with other Central Banks in those joint measures which are increasingly necessary for the proper co-ordination of monetary policies." This, which was also enjoined by the Genoa Conference and is, one may gather, the practice of the Bank of England and the Federal Reserve Board, evidently takes us far beyond the limited pre-war ideas of control. Elsewhere (paragraph 111) we are referred to the Bank's "primary duty of controlling credit and consequently the volume of the monetary circulation" and told that it is an "indispensable condition" for the proper discharge of this duty that it should centralise in its hands not only the cash reserves of Government but the banking reserves of all banks operating in India.

The purpose of all this is the stabilising of internal prices, which, if done in other countries as well, stabilises also their mutual exchanges. The machinery or powers which will be at the Banks command are mainly these: (1) the currency reserve; (2) the discretionary control of remittance on behalf of the Government; (3) the discount policy by which the bank will regulate credit through the re-discounting of bills, provided that a sufficiently large bill market can be brought into being; (4) direct operations, eventually, in the bill market; (5) control over the fiduciary issue of notes against bills. Here the range of the Bank's discretion will be wide and its action effective, provided, again, that the use of bills sufficiently expands.

This, then, as I understand it, is the correcting mechanism on which the Commission lay such stress. The old ideal of automatic currency expansion

sity for such control ; to create an appropriate instrument for its exercise ; and to devise that form of monetary system in which it shall be most effective. We must not, however, picture a Central Bank as a harsh monetary dictatorship as might be suggested by my distribution of emphasis. Monetary equilibrium is constantly being disturbed. The purpose of the Central Banking system is to secure that departures from equilibrium shall be slight and brief ; and that the adjusting processes shall be continuous and refined rather than spasmodic and violent. The Commission's phrase, "benign influence," seems happily chosen.

There is a note of authority and confidence in the passages of the report relating to a Central Bank and its functions which is very impressive. We get a picture of a serene and majestic institution—a monetary Providence indeed—securely working its beneficent will ; and we are apt to be a little carried away. But we have to remember that all this will not be attained in a moment. Before the new Bank can be instituted at all there are some very difficult practical questions to be settled which arise out of the special position and claims of other institutions ; and in the early stage of its working its scope will be limited by the absence of a big bill market. There are special obstacles in India to the rapid development in this respect which the mission anticipate. India, too, is a country of cash transactions, in which we would expect the reactions to credit control to be less immediate and less extensive than in countries with highly developed banking systems. Thus, there may be difficulty and opposition before the new Bank is launched and disappointment later with the immediate results. The one thing needful is that the main conception should not be compromised. The Commission are absolutely right—at any rate their Report has convinced me personally on that point—in their insistence that a true Central Bank cannot be obtained by some transformation of the existing Imperial Bank of India.

Given such a Central Bank as the Commission propose and the adoption of their scheme in all its essentials, one cannot question that the new system will be of great advantage to India, both as a complete and modern monetary system and by its influence on development, as for example, future banking development. There may yet be occasion for further formal enquiries to deal with particular phases of India's monetary problems. But I can hardly think that the whole structure will need to be once more rebuilt, as long as gold continues to be the generally-accepted standard of value.