

INDIAN CURRENCY AND EXCHANGE

WITH ITS
HISTORY AND DEVELOPMENT.

BY

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PREFACE

Though of late Indian Currency and Exchange has received a good deal of attention at the hands of economists and publicists, it still remains for many a fairly difficult subject. To understand it two things are required: (1) a clear and definite knowledge of its history and development and (2) a thorough study of the reports of the currency committees appointed from time to time to examine and amend it. I have traced this history chronologically from 1835, the year in which the Indian currency was consolidated and placed on a sound basis, to the year 1932. I have laid particular stress, in tracing this history, on the changes introduced into it from time to time and the shape it took after each of such changes was made. In the second place I have given a full and critical analysis of the reports of the currency committees and discussed at length the nature of the changes recommended by them and the effect of such changes on our currency system. These reports are very valuable documents for every kind of information on currency questions; they are to be read and re-read, if Indian currency is to be properly understood.

I express my sense of gratitude to the numerous authors whom I have consulted freely in writing this book. My thanks are also due to R. S. Jaura, Esq., B.A., B.T., my publisher, for the trouble he has taken in correcting the proofs. There are, I fear, a few printing mistakes for which I crave the indulgence of the reader.

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Khalsa College,
Lyallpur.
25 June, 1932.

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CHAPTER I

MONEY AND ITS VALUE

DEFINITION AND KINDS OF MONEY

To understand the Currency System of India one is required to have a clear conception of money and its relation to prices and the principles underlying foreign exchanges. There is a very close relation between money and price. Both the subjects have a fairly large literature and many ramifications, all of which we need not traverse. We will set forth only those principles with which we are directly concerned. In this Chapter we will deal with money and in the next with foreign exchanges.

Money denotes anything which is widely accepted in payment for goods, or in discharge of other kinds of business obligation. This *wide acceptability* or, as Professor Fisher puts it, *general acceptability* is the characteristic feature of money. A coin or a currency note, as we call convertible paper money in India, is money as it is widely accepted in payment for goods or in discharge of any other kinds of business obligations. There are other instruments which serve the same purpose but which are not so widely accepted; such are cheques, bills of exchange and hundis. As goods are often purchased or obligations discharged with them, they serve, to a certain extent, the purpose of money; but we know that they are not widely accepted; hence, strictly speaking, they cannot be called money. There is an obvious difference between a cheque that you draw upon your bank and a currency note. People will readily accept the currency note, but they will hesitate to accept the cheque. It is worth

noting that a coin or a note issued by the government may not be accepted widely and hence cannot be regarded as money according to our definition. On the other hand a thing may pass from hand to hand freely in discharge of business obligations, without any government authority and thus serve as money. Such are the "Maria Therasas" of Europe and "Dhebuas" of Bihar. But it happens very often that money which is issued by the government is generally more acceptable to the people than any other instrument of credit. Money is also sometimes defined simply as a 'medium of exchange.' This is a wider definition.

Kinds of Money

Money may be of different kinds. Thus money is divided into standard coin and token coin. A standard coin is that coin: (1) with the value of which the value of other things is generally compared, or, as is often said, it is standard of value; (2) further its intrinsic value; *i.e.* the value of the metal in it, is equal to the value of the coin; and (3) it is freely coined and melted. A token coin is one the intrinsic value of which is less than its face value. Thus in India rupees, nickel four anna, two anna and one anna pieces are token coins, as the value of the metal in them is less than the value of the coin; so are the copper coins and paper notes. What is meant here is, that though by exchanging 4 four-anna nickel pieces, one can get a rupee, by melting these four-anna pieces, one can only get much less. If one however melts a British sovereign and sells it in the market as an ordinary commodity, one will get in exchange of the metal as much as one will get in exchange of the coin. The British sovereign is a standard coin. It is necessary that standard coins should be allowed to be freely coined and melted; if that is not allowed, there is a likelihood of such standard coins losing their characteristics. The value of the token coin is

maintained, it should be distinctly understood, by restriction of coinage; such coins are always minted by the government alone which generally by issuing a limited number are always in a position to maintain its artificial value. It would be interesting to know what is likely to happen, if this restriction is removed. On its removal people will find that it is much more profitable to them to buy nickel in the market and get it coined into nickel pieces as such pieces, being money, will have a greater exchange value than as metal. If they are allowed to do so, there will be very little difference in value between the coins and the metal. Similarly if the British sovereign is not allowed to be freely minted, its value as a coin may be greater than its value as bullion. If for some reason or other the value of gold falls, the value of the sovereign as a piece of coin will be greater than the value of the bullion in it, and thus the sovereign will become a token coin. But if it is allowed to be freely coined and melted, such a divergence can not take place. So long as any one can secure gold coin from the mints in any amount for the same weight of gold bullion of standard fineness, and so long as gold coin can be freely melted down into gold bullion, there can hardly be any appreciable difference between the value of a gold coin and the value of its metallic content.

A coin may be full legal tender, or limited legal tender. A full legal tender coin is one with which a person can pay off his debt to an unlimited extent. A limited legal tender coin is one with which a person can pay his debt only to a limited extent. In India the rupee and the silver half-rupee are full legal tender, *i.e.* a person can pay off his debt for any amount with rupees or half rupees. The nickel and the copper coins are legal tender upto one rupee only; in other words if a person buys a thing for rupees 2 and wants to pay the price in 8 four-anna nickel pieces, the seller

may legally refuse to accept 8 pieces of nickel coins; under the law he can be compelled to accept only 4 such pieces. As a matter of fact, he readily accepts 8 pieces or more; but this is his own choice. Such coins are generally called subsidiary coins. A cheque or a bill of exchange is not legal tender at all; people may refuse to accept the cheque drawn on the most well-established bank; and if they do so, they will be perfectly within their rights. Money again may be convertible or inconvertible. The currency notes issued by the government are convertible. They are convertible or redeemable into the standard coin of the country. Convertible money may be full legal tender; the Indian currency notes are so.

Indian Money

In India we have in the first instance the silver rupee which is unlimited legal tender and is also standard of value. But it is not freely coined and its intrinsic value, *i.e.* the value of the bullion in it, is less than its face value; *i.e.* it is a token coin. Its face value is now 1s.6d; but the value of the bullion in it is worth much less. The paper notes issued by the Government of India are convertible money and full legal tender. Their holders may demand rupees from the Government in exchange for them. This is a peculiar feature of the Indian currency. One kind of token coin is converted into another kind of token coin. Another feature worth noting is that in an exchange standard the rupee, though inconvertible into gold for internal purposes, is convertible into gold for external purpose at a fixed rate. The subsidiary coins are the nickel and copper coins; they are token money and legal tender upto one rupee only. The silver eight-anna pieces are, however, full legal tender. No gold coin is legal tender in India. The British Sovereigns

and half-sovereigns were legal tender from 1899 to 1927; in that year they were deprived of that characteristic and have ceased to be legal tender.

Convertible paper money

The strength of the convertible paper money lies in the fact that it is redeemable on demand into the standard money of the country. If the people have confidence in government, such money will be accepted readily by them. It is said that when the economic conditions are backward or the political conditions unstable, people will insist on using standard money. This is partly true of India. Governments also regulate the total amount of the note-issue. The general principle, which is also the most important principle, is the obligation of the Government to redeem it into standard coins. Hence Governments are to keep always a certain amount of coins and bullion in their reserve for this purpose. But as all the notes are not likely to be presented for encashment, reserve to the extent of the entire note-issue is never kept and need not be kept. Only a certain part of the entire issue is kept "covered." Notes to that extent are called "covered issue". But notes are issued, often a fairly large percentage of the total issue, against which there is no such backing. Against this part of the issue, there are the securities. This part is called the "uncovered" issue or fiduciary issue. The amounts of covered issue and 'uncovered issue' are decided by the Governments which, in doing so, take into account the habits of the people and their readiness to use the notes as currency. But these decisions are often arbitrary, and there is no relation between the covered amount and the uncovered amount. For an illustration we may take "the Currency and Bank Notes Act, 1928" of England. According to that Act the fiduciary portion of the note-issue was fixed at £ 260,000,000; notes issued above that

amount must be covered by gold coin and bullion, pound for pound. The India system will be discussed in Chapter XI. This system is a little, what we say, inelastic. If, for some reason, the people require notes over and above the fiduciary portion, then against such additional issue there must be kept an equivalent amount of gold coin or bullion. These notes, therefore, are almost as expensive as gold and for that reason cannot be obtained easily. Hence this system is called inelastic; but this defect, which is undoubtedly a serious one, has been remedied in the case of England by an extensive use of cheques subject to deposit.

Whenever the people require money, they go to the Banks and, on the security of their own promissory notes or on the strength of other securities, get a right to draw cheques on the banks.

Convertible paper may circulate as freely as coins; and people do not make any distinction between a convertible paper money and a gold coin as long as they are assured of their convertibility by the government or any other authority that has issued it. But as soon as the confidence of the people in the stability of the government (or the issuing authority) or in their capability of converting the notes into the standard coins is shaken, such notes will either cease to circulate freely or go to a discount. Such was partly the case in India on the outbreak of the last war.*

Inconvertible Paper Money

Little need be said about inconvertible paper money. No Government, except in times of extreme and pressing necessity, ever think of issuing it. It is a paper money which cannot be converted into the currency of the country. The great and perhaps the only advantage of such money lies in its cheapness. Gold and

* See Chapter 9.

silver can be produced with much labour; if the gold or the silver currency is to be increased, new gold or silver is to be purchased. Paper money costs a trifle; it can be increased to any amount with a little cost. Coming to the disadvantages we find that in the first place it may not circulate freely; and if it does not, it ceases to be money. This may happen even if it is made legal tender. This happened in California during the Civil war from 1862—1872. A widespread refusal to use it not only affects its circulation but also its value. People refuse to accept it and it goes to a discount. This was the case also in 1720, when the French Government to improve their finances, which had been hopelessly mismanaged for several years, issued under the advice of Law, a Scotch adventurer, a large number of inconvertible paper notes. Then again during 1790—96 the same thing happened in France when the government issued what is known in history as *assignats*.

But what we have stated so long is the least part of the disadvantage of inconvertible paper. Its greatest curse is over-issue. Once it is issued, it is likely to be issued continuously: the temptation is so great. It is issued under the stress of extreme necessity. If it is issued upto a limited extent, it does no harm. But after it is issued in a large amount, it not only displaces the ordinary currency of the country, it raises the prices as well. And as soon as the prices are raised the expenditure of the Government increases and to meet the increased expenditure, more notes are issued. Thus a vicious circle is created. Prices of commodities rise faster than wages and than those incomes which are called fixed. Business men make money and the rate of interest rises; creditors lose and the debtors gain. "One of the greatest objections to paper issues is the unsettlement which they cause in people's ideas on the nature and effects of money. Absurd notions emerge, and

the simplest lessons of Economics must be retaught."* History shows that over-issue, always threatened by inconvertible paper money, has rarely been avoided. For a long time inconvertible paper money had been relegated to the limbo of discarded devices; the evils from its repeated and almost unfailing abuse had been abundantly proved by experience, and it was thought that no intelligently governed country would resort ever to an expedient so hazardous and harmful. But the Great War upset all such expectations. Resort was made to paper money on a scale much greater than before with results more lamentable. This paper issue was practically made inconvertible in most of the belligerent countries. In every warring country there was a rise in prices, unheard of before; this rise was felt also in those neutral countries which maintained gold standard. Gold from belligerent countries flowed to the neutral countries such as Holland, the Scandinavian countries, Spain, the United States and Japan, increased rapidly and greatly the circulating medium in all of them and brought about a revolution in general prices of a kind which was altogether unknown in the past.

Paper money, whether convertible or inconvertible, tends to drive out specie. This expulsion, as incidentally stated above, takes place through the operation of international trade. The newly-issued paper enlarges the quantity in circulation and sooner or later will raise the prices. This rise in prices causes imports to be greater, exports to be less; and specie flows out in payment of the imports. Paper cannot flow out as it does not circulate in foreign countries.

British System

A study of the British system will help us very

* Taussig's Principles of Economics: Chap. 23.

much in understanding the nature of our own currency system. Prior to the war the legal tender value of the sovereign was approximately equal to its bullion value; in other words, the amount of fine gold in a sovereign would exchange for the same amount of other commodities as would an actual sovereign. This was because in London there was a free market for gold. The Bank of England was bound by law to give out sovereigns in payment of its notes, and the people who thus received sovereigns could do what they liked with them; they could use them as currency or they could send them abroad or melt them down and use them for trade purposes. On the other hand, the Royal mint was bound to purchase all gold offered to it at the fixed price of £3 11s. 10½d. per oz (troy) of standard gold, standard gold being $\frac{1}{2}$ fine and one part alloy—the same fineness as the sovereign. The mint was also required by law to make 40 lbs. troy of standard gold into 1,809 sovereigns of equal weight. No charge was made by the Mint in recent times for the coinage of gold; and as during the time allowed for coinage there would be loss of interest, so in actual practice people who wished to sell gold took it to the Bank of England which, by Section IV of the Bank Act of 1844, is compelled to purchase all gold offered to it at the minimum price of £3 17s. 9d. per ounce standard. The sovereign was also the principal currency in the country, and the standard coin. This system is known as the Gold Specie standard. We should note that there are three different forms of gold standard:—

1. *The Gold Specie Standard which was in force in England prior to the war.* According to this the coinage of gold is free and gold coin is used as the medium of exchange.

2. *The Gold Exchange Standard.* It has been in

force in India, Straits Settlements, Philipines, Mexico and a few other countries. In these countries, the currency is not gold but is convertible into a foreign currency at a fixed price with gold.

3. *The Gold Bullion Standard*, whereby the currency is not gold but whereby the Central Bank is bound to buy and sell gold bullion without restriction at fixed prices!

This last system was adopted in England by the Gold Standard Act of 1925. By virtue of this Act, bank and currency notes have been made inconvertible into gold coins, though gold bars weighing about 400 oz. troy can be obtained from the Bank of England in exchange for legal tender at the rate of £3 17s. 10½d. per oz. This Act has also given the Bank the sole right to hand bullion to the Mint for coinage; though the Bank by virtue of Section 4 of the Act of 1844 (not repealed) is still to purchase all gold offered to it at £3 17s. 9d. per ounce*.

The note issue is regulated by the currency and Bank Notes Act of 1928, the chief provisions of which are as follows:—

1. The Bank may issue bank-notes for one pound and ten shillings.

2. These notes are legal tender for the payment of any amount.

3. The holders of bank-notes for five pounds and upwards may demand from the bank notes for one pound or ten shillings.

The bank shall issue bank-notes upto the amount representing the gold coin and gold bullion for the time being in the Issue Department (of the Bank) and in addition £260,000,000 in excess of that amount. (This is to be called the Fiduciary note issue.)

* England at present is not on gold basis; in September 1931 the gold standard was abandoned owing mainly to shortage of gold.

Value of Money

By the expression 'value of money' we mean something analogous to what we mean by the value of anything else, say wheat or rice. The value of money means the amount of things which will be given in exchange for a unit of money. Thus if for one rupee we can buy one shirt, we will say that the value of one rupee is one shirt. The only difficulty arises from the fact that we are in the habit of expressing the value of a shirt or any other commodity in terms of money, whereas obviously we cannot express the value of money in terms of itself. This value of money is often expressed by another term with which the reader should do well to be intimate and acquainted. This expression is *purchasing power of money*; it means *exactly* the same thing as the value of money.

This purchasing power of money varies. People often think, though very wrongly, that if they lend one rupee to-day and get it back a year hence, they will get back what they have lent. Not so; in the meantime the purchasing power of money may vary, it may increase or it may decrease. If it increases, in getting back one rupee, they will really get more than they lent; with one rupee they can buy more things now than they could one year back. Similarly in getting back one rupee they may get less, if in the meantime the purchasing power of money has decreased. An increase in the purchasing power of money means a fall in prices, a decrease means a rise in prices. Never is money directly used as a piece of cloth or a seer of rice; its use is always indirect. It is valued because of the command it gives over those commodities that we require either for the production of further wealth or for immediate satisfaction of our wants.

Quantity Theory of Money

There is a close relation between the amount of

money in circulation and its value. This relation has often been given the dignified name of the "quantity theory of money." The theory says that the value of money depends on its amount; if the amount of money is halved, its value will be doubled and prices of commodities will be halved; if the amount of money is doubled, its value will be halved and prices will be doubled. The theory is qualified by the statement that 'other things should always remain the same.' These other things include (1) the volume of trade and (2) the velocity of money. If these two things remain the same, the value of money will vary in inverse ratio to its amount. Thus according to Professor Irving Fisher, the value of money depends on three things:—

1. Amount of money in circulation.
2. Its velocity, and
3. The volume of trade this money is to carry on.

Thus if in a given society in a given year, say in 1930, the total amount of money spent for buying all goods is, say Rs. 1000 and the articles so bought are 1000; then Rs. 1000=1000 articles, *i.e.* Re. 1=one Article. But if in 1931 the sum used for the same purpose is increased to say Rs. 2000, other things remaining the same, then Rs. 2000=1000 Articles; *i.e.* Rs. 2=one Article. The amount has been doubled, hence price has been doubled and the value of money has been halved. Similarly if the amount of money spent in 1931 remains the same as in 1930 as well as the velocity but the value of trade, say, is halved, then Rs. 1000=500 Articles, *i.e.* Rs. 2=1 Article. Thus a decrease of trade, other things remaining the same, *viz.* the amount of money and its velocity, is equivalent to an increase of money; and increase of trade, other things remaining the same, is equivalent to a decrease of money.

An increase in the velocity of money means an increase in the amount, and a decrease means a de-

crease of money. But neither the velocity of circulation nor the volume of trade is ordinarily dependent on the amount of money in circulation. The velocity of circulation depends on factors, which have little to do with the amount of money in circulation; it depends mainly on the habits of the people.

As Professor Irving Fisher puts it, an inflation of the currency cannot increase the product of farms and factories nor can it increase the speed of freight trains or ships. The stream of business depends on natural resources and technical conditions; the whole machinery of production, transportation and sale is a matter of physical capacity and technique, none of which depends on the quantity of money. An increase in the amount of money similarly cannot change the habits of the people; hence the velocity remains ordinarily unaltered. We should note, however, that the people do change their habits; and with their habits changes the velocity of circulation. But such changes take a long time to come about and they are seldom caused by a change in the amount of money. During the war however, a new experience was gained. If prices rise rapidly, owing to inflation, the people change their habits, spend more quickly than they ordinarily do and increase the velocity of circulation. With an increase in the velocity of circulation prices climb up quickly, out of all proportion to the increase in the amount of money in circulation.* Thus we conclude that a change in the amount of money in circulation has a tendency to effect a corresponding change in the price-level, provided other things remain the same.

In countries like England a good deal of transaction is carried on with cheques, subject to deposit. It is supposed that there is a relation between the amount of cheques and currency used in a particular country at a particular time. Further there is always a close rela-

* Keynes, *Monetary Reform*, Chapters II and III.

tion between the 'reserve' in the bank and the deposit, *i.e.* the cheque. Hence a change in the amount of currency is likely to bring about a corresponding change in the amount of cheques. Thus this theory holds good even when cheques are used. Though this supposition may be true in the long run, it may not be true always. Thus the reserves of the banks may increase and cheques may not increase. This is what has happened this year. It is said that much gold is locked up in the American banks and thus the proportion of the reserve to cheques has been raised appreciably.

Thus the value of money is determined by exactly the same two factors as determine the value of any other thing, namely the conditions of demand for it and the quantity of it available. The conditions of demand depend partly on the taste and habits of the community we are studying, that is, on how far that community is accustomed to the use of money and on how it uses it, and partly on the total volume of business transactions which have to be performed within a given time with money. Given the conditions of demand for money, its value depends on the quantity of it available. If fewer units of money are available, each unit shall have to do more work; each of them shall have to be exchanged for a larger volume of goods and services; in other words the value of each unit will be greater than before. If more units are available, each unit shall have to do less; that is, each will exchange for a smaller volume of things, and the value of each unit will be less than before.

Finally, we should note that this theory, in the first place, does not assert that a change in the amount of money available will be accompanied by an exactly proportionate change in the opposite direction in the value of money. A change in the quantity of money available might itself produce a change in the conditions of demand for it, *i.e.* in the extent to which

the community insists on using money, or in the volume of things to be exchanged or in the frequency with which they change hands.

Secondly the theory does not assert that every change in the value of money is associated with a change in the volume of money available. The change in the value of money, as stated already, may be due to an increase or decrease in the volume of trade or to a change in the habits of the people.

There is one more point about this theory. When in a country, owing to an increase in the amount of money in circulation, prices rise, other countries will find it profitable to sell in that country. Money will flow out from that country to the exporting country, where in consequence of the flow of gold prices will rise. For a short time the imports will be in excess of the exports; but in course of time an equilibrium between export and import will come about, and the flow of money will be stopped. Thus a part of the additional money will find its way to other countries and raise prices there. The effect of any additional supply of money in a country is likely to be felt in many other countries. Finally it should be remembered that when money flows out from one country to another, it is the international money, *viz.*, gold, that flows out and not the local currency. If in a country owing to a large increase of currency notes or cheques (*i.e.* deposits) prices go up, gold will flow out to those countries which will be tempted to sell their commodities in the country of high prices. But from the first country, apart from the results we have talked of, gold will flow out; and therefore in that country the price of gold in paper will rise.

Gresham's Law

There is a law, wrongly attributed to a Sir Thomas Gresham, a financial adviser of Queen Elizabeth, that bad money drives away good money from circulation. This law states the common-place truth, that where coins

of different bullion value circulate side by side, the cheaper will displace the better. For illustration of this tendency, we may choose the cases of the displacement of full weight coins by light weight or abraded coins of the same metal. Until the 19th century, the machinery for manufacturing coins worked somewhat imperfectly. The coins minted were subject to ordinary abrasion and clipping; new and good coins were therefore picked out for use in arts or for exportation, while only the poor ones remained in circulation. In this connection, the meaning of the terms "overvalued" and "undervalued" should be clearly understood. A coin is said to be "overvalued", if it fetches more in the market than the amount of silver (the bullion) in it does. Thus if at the mint 15 Rs. are minted into one sovereign, and if as bullion Rs. 14 can be sold in the market at a price equal to one sovereign, no one will bring silver to the mint. A silver coin, in this case, is less valuable than the bullion it contains; it is a loss, therefore, to get the bullion coined into rupees. If that happens, people may be induced to melt their rupees and sell the silver. Here silver is undervalued. The opposite phenomenon may also take place, *i.e.*, the silver may be 'overvalued.' Thus if 15 Rs. as coins be equivalent to one sovereign and 16 Rs. as bullion is equivalent in the market to one sovereign, the value of the coin is greater than the bullion. In this case the rupees are 'overvalued.' When, therefore, the amount of bullion in a coin fetches less than the coin itself, the metal is 'overvalued,' and when bullion fetches more than the coin, the coin is 'undervalued.' The silver rupee is an 'overvalued' coin because the amount of silver in it will fetch much less than 1s. 6d., the present gold price of a rupee. If a coin is 'undervalued' it is likely to be melted and sold as a bullion in the market; if it is 'overvalued,' the metal is likely to be presented to the mint, provided free coinage is allowed, for conversion into coins.

CHAPTER II

FOREIGN EXCHANGE

Foreign exchange is the Science and Art of international money-changing, *i.e.* the method of changing the money of one country into that of another. When a merchant at Lahore buys an article from Bombay, all that he needs to do is either to send a cheque or currency notes to Bombay; the rupees being the same at Bombay and Lahore, no need arises of changing the Lahore money into Bombay money. But when an English merchant buys from an Indian merchant, say wheat, the former has to find out how many sovereigns will be equivalent to the number of rupees the English merchant shall have to pay to the Indian merchant; the English merchant must pay in rupees as in India, rupee is the standard of value. The second difficulty arises from the fact that the element of 'time' plays a more important part in International Trade than in Home Trade. In sending money from Bombay to Calcutta, one does not take more than two days, often less; but in sending money from Calcutta to London one will take more than 21 days. Naturally the exporter is unwilling to wait all the time for his money; and, on the other hand, the importer will not pay cash for the goods before he has got them. These two are the main points of difference between international trade and home trade.

Bill of Exchange

When two countries, say England and India, trade with each other, they have got to send money to pay for their transactions. Let us suppose that there are in India, one exporter who has sold his merchandise

to an English importer and an importer who has purchased his merchandise from an English exporter.

The Indian exporter will receive payment from the English importer, *i.e.* the English importer shall have to send rupees to him; the Indian importer shall have to send sovereigns to the English exporter. If they choose, they may send gold; but that is always regarded as a very clumsy method of doing business. In the first place there may be restriction on the movement of gold; in the second place, it is troublesome and expensive to send gold because of the cost of freight, insurance, etc.; and lastly because there is not sufficient gold in existence to settle even a small fraction of international indebtedness. What they generally do, and what is supposed to be a much better method of doing business, is to pay each other with Bills of Exchange. In the hypothetical case we have cited, all that the Indian exporter has got to do is to draw a bill of exchange, which is similar to a cheque, on the English importer and sell it to some one who requires payments to make in England. Such a man is the Indian importer; he has to send money to England; he will buy the bill and pay the price to the exporter and then send it on to the English exporter from whom he himself has purchased articles and to whom consequently he has to send money. The English exporter on receiving the bill will present it to the English importer on whom the bill has been drawn and get his money. Thus the whole transaction is settled without sending any money. If the amount of money which the Indian exporter is to receive is the same as that which the Indian importer has to send, the bill of exchange alone will complete the whole transaction. But it always happens that either the exporters have to receive more than the importers have to send or the importers have to send more than the

exporters have to receive. In this case, the balance has to be sent to the country which is to receive more. But no country stands alone; one country buys from and sells to many other countries; hence the need of sending gold, which is the international money, arises only occasionally. In actual working the exporter who always sells his bills and the importer who buys them seldom meet each other and carry on this buying and selling. This work is facilitated by the presence of the exchange banks, financial houses and numerous brokers. The exporter sells his bills to an exchange bank and gets his price; the importer buys his bills and pays the price to the bank and then sends them on to his creditors in the foreign countries, who present them to the persons on whom they are drawn and get their money.

The form of a Bill of Exchange

The person who draws the bill is called the drawer; the person on whom it is drawn is the 'drawee,' and the person who is to receive the payment is the 'payee.' A Bill of Exchange is a negotiable instrument. If payable to bearer, it is negotiated by delivery; and if payable to order, it is negotiated by the endorsement of the holder, completed by delivery. A Bill may be payable 'at sight,' three months or six months after sight. There is also another kind of bill, Telegraphic Transfer, called more often T.T. which, as the name implies, is an order sent by telegram or cable, by a person or firm in one country, e.g. England, to an agent in another country, e.g. America, instructing him to pay a certain amount of money to another person or firm named in the cable.

The exchange bills are always sold and bought like ordinary commodities; hence their price is determined by the conditions of demand and supply. If the bills for sale are larger in number than required by

their purchasers, *i.e.*, if the exporters have got more bills than the importers will buy, price will fall. Similarly if more bills are required by the importers than are offered by the exporters, there will be a heavy demand and price will go up. If the number of bills offered by the exporters is equal to the number required by the importers, the exchange is said to be at "par."

Par of Exchange

The definition of the true 'par', as given in the dictionary, is a 'state of equality.' To the exchange-dealers the expression has a technical meaning, not very different however from its dictionary meaning. This par is known as the Mint par and is the fixed intrinsic value of the currency unit of one country, expressed in the terms of the currency of another country. The value of a currency unit of a country depends upon the quantity of pure metal it contains as fixed by law. Thus a British sovereign is equal to F. 25·22 (pre-war parity), *i.e.* this amount of French currency expresses, according to French law, the same weight of gold as is contained in a sovereign. Mint par, therefore, expresses the legal ratio between the currency-units of two different countries.*

In the case of India, the executive authorities have fixed the ratio at 1s. 6d. per rupee. The rupee is an over-valued coin which can only be minted by the Government on their own behalf. A rupee contains 165 grains of fine silver. If the price of a standard ounce of silver is 43d, then the value of the silver in the rupee is 1s. 4d; at 48d, the value of the silver in the rupee is 1s. 6d. This means that if the price of an ounce of silver rises to 48d, the rupee ceases to be a token coin; its intrinsic value is then equal to its face value. If the price of an ounce of

* ABC of Foreign Exchange by Clare and Crump, Chapter III.

silver rises above 48d., it is a loss to coin rupees, because one rupee will contain silver worth more than 1s. 6d.; though as coin it will fetch only 1s. 6d. So we may say that the par of exchange is fixed at 1s. 6d. (gold) for each rupee, *i.e.* the rupee has been "pegged" at 1s. 6d. Between a country on a silver basis and one on a gold basis, there cannot be any fixed par of exchange. The value of silver always varies in terms of gold and therefore there cannot be a fixed ratio between the value of gold and silver. It is to put a stop to this kind of variation, that the free coinage of silver was stopped in 1893 and the price of the silver rupee was pegged at 1s. 4d. (in gold).

Gold Points

The bill of exchange is sold in the market as an ordinary commodity; and its price, which is often called the rate, is determined as already stated by the conditions of demand and supply. The par of exchange between England and America is £1=4·866 dollars.† If England must pay more to America than America has to pay to England, there will be more demand for dollars than for pounds; the price of the dollar in terms of pounds will rise above the par; *i.e.* the English people will get less dollars than they did before for one £. If the par of exchange is £1=4·866, it will be, in the illustration given, £1=4·855, *i.e.* when the exchange was at par the English people could get 4·866 dollars per £, but now they are getting 11 cents less. In technical language, we will say that in England the rate has fallen or become unfavourable; whereas in America the rate is favourable. On the other hand if America has to pay more to England than England has to pay to America, the Americans will require more £s than available; and the

† This was the rate before the abandonment of the gold standard by England in September 1931.

price of the £ will increase or which is the same thing, the value of the dollar will fall. The exchange may stand at £ 1=4'87. To sum up, the rate of exchange, at any specified time, is dependent upon the relative demand for the currencies of the two countries trading with each other. Thus if England has to pay more to India than India has to pay to England, the price of the rupee will rise; it being fixed at 1s. 6d., it will rise above 1s. 6d. The price will fall below 1s. 6d., if India has to pay more to England than England has to pay to India. But how much can this rate rise or fall?

If the price of a bill of exchange rises very high, the traders might find it profitable to ship gold, provided such shipment is allowed, to their creditors. If the charge of sending gold from Paris to London be 10 centimes per £, (it was the pre-war rate), a Paris importer, if he chooses to send gold, shall be required to send 25'22 francs (one £ being equal to 25'22) plus 10 centimes, *i.e.* Fr. 25'32. If the price of the Bill of Exchange rises above 25'32, nobody will think it worth his while to buy a bill; he will prefer to send gold. The price of a bill of exchange therefore cannot, if the shipment of gold is allowed, rise above 25'32. Similarly the price of exchange between Paris and England cannot fall below Fr. 25'22 minus 10 centimes, *i.e.* 25'12. These limits are known as the theoretical "gold points" or "specie points." If the price of a £ rises above Fr. 25'32, the French importer will buy gold in France, if he is allowed to do so, and ship it to England; this process will cost him only Fr. 25'32 per £. This is sometimes called the upper or Import gold point. On the other hand if the exchange falls below Fr. 25'12, the French exporter will buy gold in England and ship it home; this process will cost him only 25'22 minus the cost of transport, which is 10 centimes; *i.e.* Fr. 25'12 per £.

This is known as the lower or Export gold point.

The exports of a country have a tendency to be equal to its imports. It is a mere tendency, but it is worth remembering. If the exports of a country exceed its imports, money will flow in. As money flows in, prices will rise as well as money income. Other countries will now find it profitable to sell in that country, the people of which with their rising incomes will also be in a position to buy from other countries. Thus the imports will increase and exports will fall off. Similarly if the imports exceed the exports, money will flow out, and prices will fall as well as money incomes. If prices fall, outsiders will be tempted to buy from the country of low prices as they get their things cheaper. Money will again flow in and prices will tend to rise. This is sometimes expressed by saying that exports pay for the imports.

Purchasing Power Parity

The exchange always fluctuates; but it fluctuates between the gold points. This fluctuation is dependent on: (1) the state of mutual indebtedness to be met within a definite period of time, (2) the cost of shipping specie and (3) the rate of interest. All these items vary from day to day and bring about a corresponding variation in the rate of exchange. The Mint Par of Exchange and the specie points (gold or silver points) can only exist between two countries having the same metal as their monetary standard and may be defined as "the equivalent, in terms of one coinage, of the quantity of pure metal contained in the standard coin of the other country."

We will take now the second case into consideration; viz., that of exchange between gold standard countries on the one hand, and those with currencies based either on a free and automatic silver standard or

on inconvertible paper on the other. Here there cannot be any Mint Par of Exchange nor any specie points. In the first place the rate of exchange is governed, in such cases, by the three factors mentioned above; *viz.*, the balance of relative indebtedness, the rate of interest in the two countries and the cost of shipping specie. But these factors do not stand all alone; the rate of exchange is influenced by the variations in the gold price of silver or in the quantity of paper currency in circulation, which changes the purchasing power of the paper currencies in terms of gold.

We will now take the third case, namely, the rate of exchange between countries having inconvertible paper currencies. The rate can be found out by comparing the purchasing powers of the inconvertible currencies at a given time; and the ratios thus obtained will give us theoretical and fluctuating *pars*. This *par* is called "Purchasing Power Parity." We should note that the Mint Par is really the Purchasing Power Parity; for when both France and England have gold standard, £1 will purchase practically the same amount of commodities as 25·22 francs. If the purchasing power of £1 should increase relatively to the purchasing power of the franc, what is likely to happen is that more purchases will be made by France in England and money will flow out from the first country to the second country; this flow will continue till £1 becomes equal to 25·22 francs in purchasing power.

The simplest way to establish relationship between purchasing powers of the paper currencies of two countries is by comparing their purchasing powers with those of the pre-war currencies, between which there was a definite Mint *par*. This can be done only with the help of Index Number. Suppose that in January, 1925, the English Index Number showed a rise of 50 p.c. compared with 1913, so that £150 in 1925

could purchase only the same amount of commodities as £100 did in 1913. Let us further suppose that in France, too, during the same period, prices rose by 300 percent, so that 400 Francs in 1925 could purchase only as much as 100 Francs in 1913. Then how many post-war francs = post-war £1?

If £150 post-war = £100 pre-war

and if £1 pre-war = francs 25·22 pre-war

and francs 100 pre-war = francs 400 post-war.

Then £1 post-war = $\frac{100 \times 25 \cdot 22 \times 400}{150 \times 100 \times 1} = 67 \cdot 27$ francs.

Prof. Gustav Cassel, one of the leading economists of the present age and an able exponent of this doctrine lays down the following rule for finding out the parity:—
“when two currencies have been inflated, the new normal rate of exchange will be equal to the old rate, multiplied by the quotient between the degrees of inflation of both countries.”

The only other point we are to note is that this parity continually fluctuates because there is no relation between the variations in the purchasing powers of the paper currencies of such countries.*

* See Gustav Cassel, *Money and Foreign Exchange after 1914*, pages 141—150, Keynes, *Monetary Reform*, pages 86—106.

CHAPTER III

SOME OUTSTANDING FACTS

Balance of Trade

In trying to understand Indian Currency and Exchange, we should remember that the balance of trade is generally in favour of India. In ordinary years India possesses a large favourable balance of trade: *i.e.* her merchandise exports are, as a rule, greater in value than her merchandise imports as will be seen from the table below:—

Quinquennial averages for the past 60 years (in lakhs of rupees)

YEARS	EXPORTS	IMPORTS
1864-65 to 1866—69	55,86	31,70
1869-70 to 1873—74	56,25	33,04
1874-75 to 1878—79	60,32	38,36
1879-80 to 1883—84	79,08	50,16
1884-85 to 1888—89	88,64	61,51
1889-90 to 1893—94	104,99	70,78
1894-95 to 1898—99	107,53	73,67
1899-00 to 1903—04	124,92	84,68
1904-05 to 1908—09	165,44	119,85
1909-10 to 1913—14	224,23	151,67
In the year 1914—15	121,4	96,1
” 1915—16	133,0	92,1
” 1916—17	167,9	106,8
” 1917—18	163,3	109,6
” 1918—19	170,2	125,2
” 1919—20	336,02	221,70
” 1920—21	267,76	347,57
” 1921—22	248,65	282,59
” 1922—23	316,07	246,19

	YEARS	EXPORTS	IMPORTS
In the year	1923—24	363,37	237,18
"	1924—25	400,24	253,37
"	1925—26	386,81	236,00
"	1926—27	311,04	240,91

The exports, we know, pay for the imports; if however, the exports exceed the imports, money, *i.e.* gold will flow into the exporting country. Money therefore, flows into India and has been flowing in for a long time past in the shape of treasures, chiefly gold and silver, and funds obtained by the Secretary of State by the sale of Council Bills. The Council Bills, as will be found later, play a very important part in Indian Currency and Exchange. These Bills can only be sold; this is what we have to remember, when the balance of trade is in favour of India; *i.e.* when the outside world has to send more money to India than India has to pay. The foreign merchants buy these Bills, pay the price to the Secretary of State in gold and encashing them in silver in India, pay their creditors. If however, the balance of trade turns against India as it did in 1921—1922 and 1922—23 and in other years, no money need be sent to India at all; on the contrary money will flow out from India. In this case the Indian importers will have to send money to the foreign countries.

There will be no demand then for Council Bills. So in the years 1921-1922 and 1922-23 the Secretary of State could not sell Council Bills. In such years with a view to strengthen the exchange, Reverse Bills are sold by the Government of India. Since 1925 the sale of Council Bills has been stopped; remittance is now made by the purchase of sterling in India. The favourable balance is thus liquidated by import of funds obtained by the sale of Council Bills and placed at the disposal of the Secretary of State and also by import of treasures. The tables given below will explain the situation clearly.

	Average of 5 years				
	1 1883-84	2 1888-89	3 1893-94	4 1898-99	5 1903-04
Export of merchandise (excluding government stores.)	52,680	59,053	69,940	71,633	83,013
Imports of merchandise (excluding government stores.)	31,966	39,014	45,167	46,527	52,286
Net exports ...	20,714	20,039	24,773	25,106	30,727
Imports of treasures and funds.	20,007	20,492	24,413	23,953	29,341
(a) Net imports of trea- sures (gold and silver.)	6,920	8,026	9,540	5,667	9,780
Enfaced rupee paper (imports).	...	...	...	353	567
Enfaced rupee paper (exports).	660	114	327	...	...
Interest on enfaced rupee paper.	567	580	660	553	467
(b) Council Drafts paid in India.	13,180	12,000	14,540	17,380	78,507
Fund supplied by the govt. to finance the wheat purchased.	...	...	...	...	...
(c) Reverse Drafts paid in London.	...	...	...	...	...
Net ...	13,180	12,000	14,540	17,380	18,507
	+707	-453	+360	+1,153	+1,386

Note:— + indicates balance in

in India
TO 1918-19)

29

(In thousands of £ sterling)

ending							
6 1908-09	7 1913-14	8 1914-15	9 1915-16	10 1916-17	11 1917-18	12 1918-19	
110,206	149,411	121,061	131,587	163,434	161,703	169,242	
74,567	97,232	91,953	87,991	99,757	100,283	112,689	
35,639	52,179	29,108	43,596	63,677	61,420	56,553	
36,827	52,464	11,266	26,443	33,282	49,830	15,651	
13,994	24,048	12,313	6,984	1,357	15,277	53	
360	581	238	603	347	552	...	
...	...	...	...	...	...	464	
373	291	228	213	195	185	173	
23,707	27,509	7,194	23,536	31,383	33,816	20,609	
...	...	...	2,833	...	...	...
1,607	31	8,707	4,893	...	...	4,720	
22,100	27,538	-1,513	18,643	31,383	33,816	15,889	
-1,188	-285	+17,842	+17,153	+3,395	+11,590	+40,902	

favour of, and - against India.

	Average of 5 years ending 1923-24	1924-25
Exports of merchandise (private)	+2,85,68	+3,84,66
Re-exports of merchandise (private)	+15,62	+13,51
Imports of foreign merchandise (private)	-2,48,81	-2,43,16
<i>(Balance of Trade in merchandise (private))</i>	+52.49	+1,55,01
Gold	-13,93	-73,93
Silver	-11,79	-20,06
Currency notes	-40	-28
<i>(Balance of Transactions in treasure (private))</i>	-26,12	-94,27
<i>(Total visible Balance of Trade)</i>	+26,37	+60,74
Council Bills, Telegraphic Transport, purchase of sterling and payments of sterling.	-15,45	-56,35
Sterling Transfers on hand or sold in India.	+9,42	...
Transfer of government securities.	-5	-38
Interest Drafts on India.	-31	-41
<i>Balance of remittances of funds</i>	-6,39	-57,14
<i>Total Visible Balance of Trade</i>	+19,98	+3,60

TO 1929-30.

rupees)

1925-26	1926-27	1927-28	1928-29	1929-30
+ 3,74,86	+ 3,01,43	+ 3,19,11	+ 3,30,13	+ 31,10,80
+ 10,49	+ 8,01	+ 9,54	+ 7,13	- 7,13
- 2,24,11	- 2,29,98	- 2,46,78	- 2,38,91	- 2,38,91
+ 1,61,24	+ 79,46	+ 81,87	+ 86,47	+ 79,02
- 34,85	- 19,40	- 18,10	- 21,20	- 14,22
- 17,15	- 19,79	- 13,85	- 13,04	- 11,89
+ 12	- 14	- 24	- 12	- 9
- 51,88	- 39,33	- 32,19	- 34,36	- 26,20
+ 1,09,36	+ 40,13	+ 49,68	+ 52,11	- 52,82
- 61,24	- 2,82	- 37,77	- 41,02	- 20,39
...	+ 1,93	...	...	...
- 1,27	+ 3	+ 28	- 1	- 29
- 36	- 34	- 35	- 36	- 23
- 62,87	- 1,20	- 37,84	- 41,39	- 21,01
+ 46,49	+ 38,93	+ 11,84	+ 10,72	+ 31,81

These tables show that even when the balance is in favour of India, the entire balance is not liquidated by the sale of council bills and imports of treasures; this is because the statistics given above do not take into account certain imports which are called 'invisible' imports, as they are not recorded in trade statistics. They cannot be reduced, as Mr. Findlay Shirras puts it, to the dulness of a statistical statement. A large part of these invisible imports consists of services rendered to India by foreigners, charges for shipping, freights and interest payments, investments abroad, remittances for families in England, the premiums of insurance companies and the profits of English Banks or firms. "If we could estimate with accuracy—which we cannot—the value paid for such services as shipping freights, insurance, banking facilities etc., provided by our creditors, we should be able to put on the opposite side of the account as invisible imports, chiefly imports of services, the value which could explain much, if not all, of the excess of exports over imports."*

Absorption of Gold and Silver

In spite of this inflow of the precious metals for such a long time the balance of trade, curiously enough, has remained favourable all along. In the ordinary course of affairs this inflow of the precious metals ought to have raised the price-level in India and turned the balance of trade against her. These metals, however, do not affect prices much in India; they come to India and are lost sight of, being put in a large measure to non-productive uses. They are either hoarded or converted into jewellery. If, instead of importing such large quantities of the precious metals, India would have imported goods, we should have been much better off; if they were put into circulation, prices would tend to rise. As things stand they are a dead capital.

*Findlay Shirras, *Indian Finance and Banking*, Chapter I, Sec. II, p. 5.

Mr. Findlay Shirras computes that the absorption of gold bullion and coin in the forty-six years from 1874 to 1919 amounted to £ 250,000,000. Silver coin and bullion have also been absorbed in the same way. The table below shows the absorption of currency.

(IN LAKHS OF RUPEES)

	5 years' pre-war average ending March 31, 1914	1915	1916	1917	1918	1919
Gold (sovereigns)	10.99	7.48	—40	1.37	11.64	5.21
Rupees and half-rupees	8.78	—6.70	10.40	33.81	27.86	45.02
Subsidiary coins	62	— 21	36	97	99	2.78
Currency notes	3.29	—3.43	7.87	18.18	15.48	51.70
Total	23.78	—2.86	18.23	54.33	55.97	104.71

This absorption is due, among others, to the following causes:—

(1) India is a vast country without adequate means of communication and conveyance. The currency has to cover vast areas, from which it is difficult for it to come back, once it has entered them. "The stream of rupees into those parts is like the stream of an oasis which gets lost in the thirsty sands of the desert."*

(2) People in India are not educated, and they have not yet learnt to trust the Government and invest their money; the vagaries of the monsoon on which depend about $\frac{2}{3}$ rds of the people of India have also created distrust in the minds of the people.

(3) Added to these facts is the absence of a sufficient number of banks.

Finally this absorption of gold and silver is a standing menace to the government as it may reduce the

* Findlay Shirras, Indian Finance and Banking, Chapter I, p. 14.

rupee balances and create difficulties in converting the notes. Uneducated people get panicky very easily as they did during the last great war; as soon as they get panicky, they refuse to part with gold and silver and hoard or convert them into ornaments. Further this absorption stands in the way of the automatic expansion or contraction of the currency.*

Rupee

Finally, before passing on to our subject-matter, a short history of the rupee, our store and standard of value, will be of some help to us as it will throw much useful light on many problems we have to study in the following pages.

It is said that the silver rupee was introduced as far back as 1542 by Sher Shah, the weight of which was $11\frac{1}{4}$ mashas (equivalent to 178.25 grains of pure silver).† Since then the rupee has been in existence; it is now about 390 years' old. During the early years of the administration of the East India Company there were in circulation coins, both gold and silver, of various denominations. In 1818 the Madras Government thought it advisable to have a uniform system of currency in that Presidency and declared that from 1818 the silver rupee was to be the standard coin in the Presidency and was to contain 165 grains of pure silver and 15 grains of alloy. The coinage of the pagoda, a gold coin of 52.56 grains, which was the standard coin in that Presidency, and was in active circulation for a long time, was also discontinued. In 1829 the Currency of Bombay was equalised with that of Madras. In 1835 the Governor-General in Council passed a resolution to the effect that thenceforth there should be one uniform rupee, which should be current in all the British possessions in India. Accordingly, an Act was

* See Chapter 13. † Findlay Shirras, *Indian Finance and Banking*, Chapter IV, page 97, footnote.

passed in 1835 (Act XVIII of 1835), declaring that with effect from the 1st September 1835, rupee, half-rupee, quarter rupee and double rupee should only be coined in the mints of the East India Company and the weight of the rupee should be 180 grains troy, $\frac{1}{2}$ fine, *i.e.* 165 grains of pure silver and 15 grains of alloy. The other coins should be of proportionate weight and of the same standard. This Act further declared that no gold should thenceforth be a legal tender in any of the territories of the East India Company.

From the passing of this Act down to the present time, *i.e.* for a little less than hundred years, the weight and the fineness of the rupee has remained unchanged. The Act also made rupee the sole standard of value in India. This rupee was a standard coin, which was freely minted and which had its face value equal to its intrinsic value. In 1893 its price was pegged at 1s. 4d., and it became a token coin in 1894. In 1920 its price was fixed at 2s. and in 1927 at 1s. 6d. The price of the rupee is fixed in such a way that its face value always exceeds its intrinsic value. If ever its intrinsic value exceeds the face value, the rupee as bullion becomes more valuable than as a coin and is likely to be melted down and sold in the market as an ordinary commodity. The intrinsic value of the rupee depends on the value of its silver content; as the value of the silver fluctuates, its intrinsic value also fluctuates. Thus the rupee with a face value of 1s. 4d. remains a token coin so long as one ounce of standard silver sells at a little above 43d. When silver sells at 44d. per standard ounce, the rupee ceases to be a token coin; its intrinsic value amounts to 16'351d. and thus exceeds its face value. The present rupee of 1s. 6d. will cease to be a token coin when one ounce of standard silver will sell at a little above 48d. The price of the rupee is fixed in such a way that it retains the

characteristics of a token coin ; in doing so the price of silver, its possible rise or fall, is to be carefully considered. Three important things are to be noted in this connection. Firstly, if its intrinsic value exceeds its face value, the minting of the rupee will mean a loss to the Government. Secondly, such rupees will disappear from circulation; they will be melted and sold off in the market. Thirdly, if the intrinsic value is much less than the face value, the rupee is likely to be counterfeited as such a process will be a source of great profit to those who will carry it on.

Effect of falling or rising exchange

The exchange sometimes falls or rises. In the case of the rupee the exchange is maintained by the Government at a fixed parity with gold or sterling. This exchange is also fixed by the Government. Thus from 1899 to 1917 the exchange was maintained at 1s.4d. gold; in 1920 it was fixed at 2s. gold; but it could not be maintained. From 1921 to 1924 the government did not try to maintain the exchange, which was determined by the conditions of demand and supply. From October 1924 to July 1925 the rupee was linked with sterling and maintained within the limits of 1s. 6 $\frac{3}{4}$ d. and 1s. 5 $\frac{3}{4}$ d. In April 1925 sterling reached its pre-war gold purity; and since then the rupee has been maintained at 1s. 6d. gold. In 1927 the rupee was linked to gold at 1s. 6d., at which it was maintained till September 1931. In that month the Government of India on the recommendation of the Secretary of State for India linked the rupee to sterling at 1s. 6d.

We are to note now the effects of low or high exchange on Indian trade.

A falling or low exchange, it is argued, stimulates exports and checks imports. This argument takes the following shape. When Indian article is sold in a foreign market and price remains the same there, a

fixed amount of article will bring the same gold price, but the same gold price does not mean the same rupee price. When the exchange is low, say 1s. 4d. for one £, one receives 15 Rs; when it is high, say 1s. 6d., one £ brings only Rs 13-5-4 pies. Thus a low exchange brings more rupees. If prices and wages remain the same, the Indian exporters get more rupees, and make a higher profit which stimulates production and exports. But this profit will last as long as prices and wages do not rise. But as the new rupees will be sooner or later put into circulation, prices and wages will rise and the elements of profits will disappear. The alleged stimulus will cease to operate. Thus the effects are only temporary in nature.

A low exchange tends to check imports. A foreigner selling his articles in India will get the same amount of gold as before, but an Indian pays Rs 15 when exchange is at 1s. 4d. and Rs 13 $\frac{1}{3}$ when exchange is at 1s. 6d. At 1s. 4d. he pays more and at 1s. 6d., he pays less. Therefore at 1s. 4d. he buys less and at 1s. 6d. he buys more. But the effects, we should remember, are always temporary.

CHAPTER IV

HERSCHELL COMMITTEE, 1893—1898

Currency till 1893

The year 1893 is the starting point of our enquiry. In that year the Government of India proposed to take steps, the subject-matter of the present Chapter, which not only changed the entire nature of the currency, then obtaining in the country, but led to the establishment of a system which was neither thought of nor desired at that time. Till 1893, the Indian currency was on silver basis. Rupee was then, as it is now, the standard of value; but it was then a standard coin which it is not now. Being a standard coin, it was freely minted and its face value was equal to its intrinsic value; it rose or fell in value according to the rise or fall in value of silver bullion in the market. Generally, and particularly for our purpose, its fall or rise in value was calculated in terms of gold. This fluctuation in the gold price of the rupee was always a matter, we should do well to remember, of very great annoyance to the Government of India. That Government used, as they do now, to collect their revenue in rupees and had to pay a fairly large sum of money every year to defray certain charges in England, called the Home Charges. These payments were made, as now, in gold. The Finance member has always to calculate in the Budget, how many rupees would be equivalent to the amount to be paid in gold in England. That calculation evidently can be made on the basis of the gold price of the rupee; and a little fluctuation in the gold price of the rupee is

likely to upset the entire calculations made in the budget. As we shall have to revert to this subject presently, more fully, we need not spend more time over it now.

Proposal of the Government of India

Such a fluctuation in the gold price of silver became very marked from 1873—74. From that year onward, the price of silver in gold began to fall steadily; and by the year 1893, the year of our enquiry, the price of rupee fell from 1s. 10'351d. in 1873-74 to 1s. 2'985d. The Government of India, under these circumstances, mainly for the reasons stated in the latter part of the preceding section, found it very difficult to frame their budget. They, therefore, proposed to stop the free coinage of silver, with a view to limit the issue and thus to raise its price and to introduce gold standard in India. As the step proposed to be taken was a very important one, the Secretary of State for India appointed a Committee in 1893, known as the Herschell Committee after its Chairman, to enquire into the matter and recommend proposals to improve the currency system of India.

Fall in the price of silver

The first question that the Committee discussed was whether there was any fall in the gold price of silver. The Committee found that the price of silver in gold had been falling steadily for some years past, with a little upward movement in 1890. The Table below will show the rate of this fall:—

Years.	Average price of silver per ounce.	Average rate of exchange. (pence per rupee.)
1874	59 $\frac{1}{4}$	22'351d.
1875	58 $\frac{5}{16}$	22'221d.

Years.	Average price of silver per ounce	Average rate of exchange (pence per rupee)
1876	56 $\frac{1}{4}$	21·645d.
1877	52 $\frac{3}{4}$	20·491
1878	54 $\frac{13}{16}$	20·790
1879	52 $\frac{9}{16}$	19·761
1880	51 $\frac{1}{4}$	19·961
1881	52 $\frac{1}{4}$	19·956
1882	51 $\frac{11}{16}$	19·895
1883	51 $\frac{5}{8}$	19·525
1884	50 $\frac{9}{16}$	19·536
1885	50 $\frac{3}{8}$	19·308
1886	48 $\frac{5}{8}$	18·254
1887	45 $\frac{1}{2}$	17·441
1888	44 $\frac{3}{8}$	16·899
1889	42 $\frac{1}{2}$	16·379
1890	42 $\frac{1}{4}$	16·566
1891	47 $\frac{11}{16}$	18·089
1892	45 $\frac{1}{16}$	16·738
1893	39 $\frac{13}{16}$	14·984

Causes of the fall

This fall in the price of silver in terms of gold was ascribed by the Committee to the steady increase in the production of silver since 1881. Another cause which was curiously not mentioned by the Committee was the release of a large amount of silver from many

European countries which demonetized silver and took to gold standard about this time. The sudden rise in 1890-91 was due to the passing of the Sherman Act in America which imposed on the American Government the obligation of purchasing not less than 54,000,000 ounces of silver every year; this purchase increased the demand and hence led to a rise. Further, the anticipation that in future the mints might be opened to the free coinage of silver had also an indirect effect on the price of silver. But the rise was only temporary; from the next year, as is shown in the table, the price began to fall steadily.

The Committee further held that the fall in price was likely to continue in future. In the words of the Committee, "it would be imprudent to act on the assumption that no further fall was possible or probable." There was also the possibility of the Sherman Act being repealed; and the repeal of that Act was likely to be followed by a heavy fall in the price of silver. As soon as that Act would be repealed, the American demand would cease, and supply being larger than before, the price would very likely fall still more.

It was argued that the fall in the price of silver could not continue for a long time. A continuous fall in the price of an article is sure to check its further production. If the expenses of production are higher than the price which the article in question fetches in the market, no body (we are here enunciating an elementary principle of Economics) will think it worth his while to produce it. In the case of silver, too, if its expenses of production are higher than its price in the market, it is natural to expect that its production will be contracted. This contraction is generally carried out by closing the bad mines. In the case before them, however, the Committee found that 'it was remarkable that a period of continually increasing fall in the price

of silver has been coincident with a large increase in the production of that metal.' The table below shows that, inspite of a steady fall in the price of silver, its total output, instead of decreasing as was natural, increased steadily.

Year	Average price of silver per oz.	Total output in ozs.
1876-1880	52 $\frac{3}{4}$ d.	78,776,000
1880-1885	50 $\frac{5}{8}$ d.	111,213,000
1891	45 $\frac{1}{8}$ d.	114,453,000
1892	39 $\frac{1}{8}$ d.	152,102,000

The table, given above, is in one respect at least, very remarkable. Though the price fell down from 52 $\frac{3}{4}$ d. in 1876-1880 to 39 $\frac{1}{8}$ d. in 1892, the output was nearly doubled in the latter year. With these figures before them the Committee concluded that at the low price of 1892, the production of silver was profitable in a large proportion of the mines and that a further fall in the price might not necessarily diminish the output. This increased output might be due also to the specialized nature of the mining industry; many mines would be worked at a loss in the hope that rich deposits of ores might be found later, or altered circumstances might raise the price and make good the loss the industry might have suffered before. The Committee thus held that not only there had been a steady decline in the price of silver for some years past, but the decline might continue in the future.

Effects of the fall in the price of silver.

The Committee then went on to discuss the effects of this fall in the price of silver on the finances of the Government of India and the trade and the general prosperity of the country.

On the Government of India. This fall had a very injurious effect on the finances of the Government

of India. The Government of India, as it has already been explained, had to remit in those days, as it has now, a large sum of money in payment of certain dues, known popularly as the Home Charges. This payment is always made in gold. The Government have to calculate how many rupees, the standard of value in India, will be needed to make that payment. If the price of the rupee falls, they require more rupees to make that payment: if the price rises, they will require less. The Committee calculated that in 1873-74 India had to remit £13,285,678 to England in discharge of their gold obligations; that amount was equivalent to Rs. 14,265,700 at the rate of exchange which was in that year 1s. 10·351*d.* (the price in gold of one rupee). In 1893 the amount remitted for the same purpose was £16,532,215; the price of the rupee had fallen in that year from 1s. 10·351*d.* in 1874 to 1s. 2·985*d.* and hence the amount required to make that payment (£16,532,215) was Rs. 26,478,415. If this payment could have been made at the rate of 1873-74 (*i.e.* 1s. 10·351*d.* per rupee) it would have needed only Rs. 17,751,920. Thus the Government had to pay Rs. 26,478,415—Rs. 17,751,920=Rs. 8,726,495 more, on account of the fall in the price of the rupee. But this was not all. As a further fall in the price of the rupee was anticipated, the Government feared that it would be extremely difficult to frame the budget and to meet the expenses in future. These difficulties of government were explained by Sir D. Barbour, the Finance member of the Government of India, in a statement to the Committee, a part of which we quote here. "The immediate cause of our financial difficulties.....is the fall in the gold value of silver which has added to the Indian expenditure in two years more than four crores of rupees. If that fall could be stayed and the rate of exchange could be fixed permanently at the present

low figure, the difficulty of dealing with the present deficit would be comparatively light. The revenue continues to grow in a satisfactory manner.....If we could feel assured that there would be no further fall in exchange (price of rupee in terms of gold), I have little doubt that increase of revenue, restriction and reduction of expenditure with possibly some taxation of a temporary nature, would in a very short time re-establish equilibrium". The Committee agreed to this view. A further fall in price, the Committee had reasons to believe, would make the situation more embarrassing and add considerably to the financial difficulties of the Government of India. From the viewpoint of the Government the situation was undoubtedly very critical. Not only no proper budget could be framed but new taxes were required to meet the increased expenditure, occasioned by the fall in the price of silver. A further fall, as stated by Sir D. Barbour, was sure to make the situation worse. The repeal of the Sherman Act, it was feared, would lead to a further fall in the price of silver by 6*d.* per ounce. Such a fall, the Committee thought, would reduce the price of silver to 1*s.* 0*d.* per rupee and involve the necessity of raising Rs. 6,612,000 more than would be required by the Government of India to effect, at the rate of exchange of 1*s.* 3*d.* per rupee, a remittance of £16,530,000. In 1892-93, the Government estimate of this remittance in rupees, at the rate of 1*s.* 3*d.* per rupee was Rs. 30,992,000, and at the rate of 1*s.* 0*d.* per rupee, Rs. 38,740,000, involving an increase of Rs. 7,748,000.

It should be noted, however, that what troubled the Government was not a low exchange, but the fear that the exchange might fall still further. This fear was a little exaggerated both by the Committee and the Government of India. During the ten years from 1883 to 1893, taking bad years with good

years, there had been on the whole a surplus in the budget, though during this period the expenditure had increased owing to non-recurring contingencies, such as the cost of annexation of Upper Burma, and fortifications of North-Western Frontier, etc.

On the people. We have seen that owing to the fall in the price of the rupee, more rupees were required in India to meet the gold obligations, *i.e.* the home charges. These gold obligations were, as they are to-day, discharged by the excess of exports over the imports of Indian produce. The question for consideration was what effect the fall of exchange (gold price of silver) would have on the amount of produce which must be exported to meet these obligations. To determine this, gold price of the produce must be assumed to be stationary, *i.e.* the same amount of produce would fetch the same amount of gold. A fall in the value of silver, other things remaining the same, is likely to cause a rise in the prices of articles sold in India. If a fall in the value of silver is accompanied by a corresponding rise in the prices of articles, then there is no change anywhere. If more silver is required to meet the gold obligations, and that was the case in the year under review, the same amount of produce which before the fall in the price of silver used to fetch a certain amount of silver, will bring a greater amount and thus the gold obligations can be discharged by the same amount of produce. This adjustment between the value of money and the prices of commodities takes a little time to complete. But sooner or later this adjustment is sure to take place. During the interval, prices of commodities do not rise so much as the value of silver falls; hence the same amount of produce will bring, until the adjustment is complete, less money than the fall in the value of the rupee warrants. The Indian producers, particularly the agriculturists, were therefore to suffer a little

loss for a short time; but this loss was only temporary. This was the argument of the Committee.

Shifting of burden of taxation. But the Committee argued that, though the loss was of a temporary nature, the fall in exchange had certainly shifted the burden of taxation from one class to another. Those who paid a fixed revenue under a permanent settlement had gained; they paid the same amount as before, though their incomes, owing to a rise in the prices of agricultural products, had increased. On the other hand, the salt tax, levied with a view to meet the deficit caused by the fall in exchange, was a great burden on the poor people and on those who had not gained any thing but lost on account of the rise in the prices of commodities. When price rises (once more we are laying down an elementary principle of Economics) those who receive fixed payments suffer; they get the same amount as they did before; but formerly they spent less as the prices were lower and gained much. When prices go up and their wages which are always slow to rise, being bound by custom and tradition, remain the same, they spend more owing to a rise in the prices of commodities. But the producers, a term which includes agriculturists, manufacturers and merchants, gain.

On Commerce. A fluctuating exchange might have, the Committee held, a disturbing effect on the growth of trade: it might have the effect of 'paralysing' business for a time. In a fluctuating exchange, there is always an element of uncertainty which creates panic in the minds of the business people who, in consequence, are apt to contract their business. It was not a low exchange that was embarrassing but a changing or a falling one. There can be no doubt that a steady and fixed exchange is very conducive to a healthy growth of commerce.

Alleged stimulus to export. Some of the witnesses before the Committee argued that a falling exchange

would always stimulate export and hence would be beneficial to the country. The Committee hesitated to accept this argument. In their opinion a falling exchange theoretically, no doubt, would bring more money to the country which might stimulate production, as production would become profitable owing to a rise in prices. A falling exchange always brings more rupees than a high exchange. Thus when the exchange was fixed at 1s. 4d. per rupee, one sovereign was equal to Rs. 15; at 1s. 6d. the sovereign will be equivalent to Rs. 13-5-6; *i.e.* at a low exchange India gets Rs. 15 and at a high exchange Rs. 13-5-6 only for an article worth one £. Though the amount of the produce and its gold price might be the same, the silver price would vary. We are to remember that a rise in prices is profitable to the producers for two reasons, *viz.*, wages do not rise so rapidly as prices and interest similarly rises slowly. As all the producers have to pay wages and borrow money, they gain in times of rising prices; they pay the same wages and a low interest though they gain more than before owing to a rise in the prices of commodities they deal with. But such a profit is temporary; in course of time both the wages and interest will adjust themselves to the new prices, *i.e.* rise and then the elements of profit will vanish. The Committee also found that the statistics of trade did not support the theory just propounded. Similarly they found that a falling exchange which might generally be expected to check imports did not do so.

This was a very important finding. Whatever may be the theoretical value of the theory laid down just now, it is considerably modified in practice. Thus though the gold value of the rupee fell from 23·126*d.* in 1871—72 to 20·508*d.* in 1876—77 or about 11¼ percent, the exports of merchandise were actually less in the latter year than in the former year, although in 1876—77 their rupee-

value exceeded the rupee value of the exports of either 1870—71 or 1872—73 by about 10 percent. From 1878—79 to 1884—85 exchange was fairly steady, the average rates varying only between 19·961*d.* and 19·308*d.* per rupee; during these years the exports rose by 36½ percent. Again between 1884—85 and 1888—89 the fall of the rupee was very rapid; it fell from 19·308*d.* to 16·379*d.* or over 15 percent; but the exports increased during these years by 16½ percent. During 1871—72 to 1876—77 when exchange fell by 11¼ percent, imports of merchandise increased by 17 percent; from 1878—79 to 1884—85, when the exchange was steady, the imports increased by 47 percent; and during 1884—85 to 1888—89 when the exchange fell by 15 percent the imports rose by 25 percent.

On Foreign Capital. The Committee, however, held that a fluctuating exchange or a falling exchange tended to check the investment of British Capital in India. Much of this foreign capital used to come in those days, as it even does now-a-days, from the London money market. In the opinion of the Committee, "London hesitates to lend money to countries with a silver basis," particularly when there was uncertainty about the rate of interest and a likelihood of a diminution of the invested capital in case it was to be retransferred to London. British people might hesitate to lend money to India. This argument is that if the exchange falls, more rupees would be required for a fixed quantity of gold. It was pointed out by the Committee that owing to a general fall of prices all over the world, capitalists were reluctant to start new business or invest money in new industrial enterprises. A gold standard in that case would not remedy the evil we are talking of.

On British Officers.

It also became difficult, owing to the falling exchange, to procure and arrange for the services of

European employees, required for carrying on industrial undertakings in India; because this falling exchange had its effects on salaries, savings and pensions. The Government servants were also equally affected. They had to remit money to England to maintain their children and families. At a high exchange, say 2s. per rupee, they would require Rs. 10 to make a remittance of one sovereign; at a low exchange, say at 1s. 4d. they would require Rs. 15. Thus when the exchange was falling very low, these officers required more rupees to make the same remittance. The difficulties of the service men were, we should remember in spite of what the Committee thought, not of a very serious nature. They did not suffer any appreciable loss. The loss in remitting money to England was compensated, to a great extent, by the fall of prices in England and other countries. In the next place it must be admitted that the salaries of these officials were higher than what they ought to have been. This fact was pointed out by Mr. Adams in his evidence before the Committee.

Lastly, the Committee held that the system of open mint had attracted much more silver than was needed. This importation of unnecessary silver added to the amount already existing in the country and had worsened the situation.

Finally the Committee held that if the fall would still continue, all the evils stated above would not only be aggravated but would call for heavier taxes to meet the larger deficit in the budget.

Possibility of increasing taxation

Was there any possibility of increasing the revenue by levying new taxes to meet the deficit caused by the falling exchange? The Committee held that there was little scope for such a proposal. It was not possi-

ble to enhance the land revenue as it was more or less permanently settled in the majority of cases; though the Committee held that the agriculturists had gained much by the fall in the price of rupee, *i. e.* rise in the price of agricultural products. They did not support an increase in the salt duty as they held, most rightly, that it was in the nature of a poll-tax which would fall on all classes but would press very heavily on the very poor. There was also very little scope in increasing the stamp duties, excise duties, and import and export duties. In the case of stamp duties, an increase would be a tax on the administration of justice; excise duties would not, it was thought, add appreciably to the revenue; it was thought they might stimulate illicit practice. In the case of import duties the Committee feared that the imposition of duties on cotton goods would be attacked vehemently by the British traders. Imposition of export duties was discouraged by the Committee which also held that an increase in income-tax would not yield much.

Possibility of Retrenchment

The Committee held that there was little room for any kind of retrenchment, though they half-heartedly suggested that all possible care should be taken in restricting expenditure.

Proposals of the Government of India

The Committee then discussed the proposals of the Government, the nature of which will appear from the following minute submitted by the Government to the Committee:—

“The only measures for the introduction of a gold standard into India which seems feasible are the following:—

(1) “The first measure would be the stoppage of the free coinage of silver. Government alone would retain the right of purchasing silver and coining it into rupees.

(2) "The next measure would be to open the mints to the free coinage of gold."

In his Minute Sir David Barbour, the Finance member of the Viceroy's Council, observed that "though it was proposed to stop the free coinage of silver and to establish a gold standard, it was no part of the plan to substitute gold for silver as the ordinary currency of the country." The Government contemplated that in the vast majority of Indian transactions, silver would still be used as the medium of exchange and in support of their theory they cited the examples of France and other nations all of which had a gold standard with a large circulation of token silver coins which were unlimited legal tender. For the establishment of an effective gold standard the Minute suggested that the number of silver coins should be limited and convertible into gold coins; a certain ratio was to be fixed between rupee and gold for converting the rupee into gold. It was proposed that the ratio should be fixed somewhere near 1s.6d. per rupee. By closing the mints it was expected that the Government would be able to raise the value of the rupee by limiting its number. The Government of India made the proposals, outlined above, because there was very little chance for the Brussels Conference to come to any satisfactory decision with regard to the position of silver, the continuous fall in the price of which was causing troubles everywhere. The only method left to the Government of India to arrest the fall of the value of silver and to balance their budget was to close the mints to the free coinage of silver; they also contemplated at the same time the introduction of gold standard. The Government proposed to declare by notification that the British sovereign should be legal tender in India at a rate not less than Rs. 13½; they further held that an interval of time should elapse between the closure of the mints

and the introduction of gold standard.

Effects of the proposals

If the proposals of the Government of India were to be carried out, the matters to be considered by the Committee were the possible effects of the closing of the mints on (1) the gold value of uncoined silver and (2) on the future relation of uncoined silver to the coined rupee.

With regard to the first point the Committee found that the average amount of coinage in India per annum between 1886 to 1893 was about Rs. 9,122,000. The average amount of silver per annum imported during the period was about Rs. 8,328,344. Thus nearly the whole of the silver, imported during this period, passed through the mints. The Committee also found that this amount was nearly one-fourth of the annual production of silver in the world. The American demand amounted to one-third of the total annual production. If the Government of India were to close down the mints there ought to be, according to the ordinary principles of Economics, a fall in the value of silver. Over and above this, if the American Government were to do the same, the fall would be heavier still, though in such matters no exact calculations of the rate of the fall could be predicted by any one.

With regard to the second point, all that the Committee could say was that some time must elapse before the price of the rupee could be expected to rise. There were reasons to suppose that there was already a large number of unused rupees which must be absorbed before the closing of the mints could produce any appreciable effect on the value of the rupee. Again if gold were made legal tender and mints were closed to the free coinage of rupees, there would be a demand for gold which did not exist then. This demand would

raise the value of gold against all other things, including silver; in other words, the gold price of silver might be still further diminished.

Objections to the proposals

The first objection, which appeared to many to be of an unsurmountable nature, was that *the proposals* of the Government were *unpracticable*. It would be extremely difficult, the critics said, to maintain the artificial value of the rupee. The Committee discussed this aspect of the question with admirable thoroughness. In doing so, the Committee made a rapid survey of the monetary systems of those countries which had kept in circulation an overvalued silver coin for a long time without much difficulty. The United States, with a gold standard, had a large number of silver dollars in circulation at the ratio of 16 to 1; these silver dollars were unlimited legal tender. In France, too, in spite of a gold standard, a large number of silver five-franc pieces were in circulation; they were full legal tender and were not convertible into gold. The case of France was cited by the Government of India in support of their proposals and, in the opinion of the Committee, was similar to their proposal. Here there was a currency consisting of a large number of inconvertible silver coins, the five-franc pieces, freely circulating among the people, though their value was kept at the old ratio of $15\frac{1}{2}$ to 1. The position of the rupee to-day is more or less of this nature. Of the other members of the Latin Union, Belgium and Italy had the same system as France, *i.e.* though gold was the standard metal, inconvertible five-franc pieces were in free circulation among the people at the French ratio. After considering some other countries which though on a gold basis had a large amount of silver coins in circulation, the Committee concluded that

though there were differences between them and India, it had been found possible to introduce a gold standard without a gold currency, without a gold circulation and even without legal convertibility of an existing silver currency into gold.

The existing exchange. The next objection against the proposed changes was their inexpediency. Even if the artificial value of the rupee could be maintained, was it desirable, argued the critics, to have this kind of currency? In such a system the price of rupee should have to be fixed in terms of gold; it could be fixed either at a higher rate of exchange than was prevailing then or at the prevailing rate. In the first place it was argued that if the rate of exchange were fixed at the rate then current and if the price of silver continued to fall—it was expected to do so—then the price of the rupee would be greater than the value of the silver in it; *i.e.* the rupees would be overvalued. In that case people might be encouraged to put into circulation a large number of spurious coins, a kind of business which under the circumstances mentioned would be clearly a profitable one, because the same amount of silver when coined into rupees would fetch a higher price than the silver bullion. Though the Committee could not give any definite opinion on this point, they held that in other countries with overvalued silver coins no such thing had happened, and in the case of India too there was no particular reason to think that this would happen. Further to carry on such a business on an extensive scale expensive and special machinery would be required and thus might render such a business difficult.

The effect of this system on the hoard of silver would, the Committee thought, be injurious. There was much hoarded silver in the shape of ornaments in India. Such ornaments, it was said, were brought to

the mints in times of necessity and coined into rupees. If the mints were closed, these ornaments or uncoined silver would certainly depreciate in value; *i.e.* they would fetch less as uncoined silver than they would have done as coined rupees. Coined rupees, however, would be unaffected.

It was also pointed out to the Committee that if the value of the rupee would differ from the market value of the silver, then the whole currency of India (*i.e.* the rupees) would be converted into a token currency which would be similar in principle to inconvertible paper money. In this connection the Committee pointed out that there was a good deal of difference between inconvertible paper money and inconvertible rupees. Inconvertible paper money had a tendency of being expanded unduly, and that was its greatest danger. The proposal of the Government of India, however, did not involve this danger, as the Government proposed to fix a definite ratio between the price of gold and silver. Expansion of silver currency would therefore be costly.

Another objection to the proposal of the Government of India was that by making the value of the rupee higher than its market value, they would increase the burden of taxation. That part of the revenue which consisted of fixed payment would no doubt remain unaltered; but each rupee which the cultivator would pay would be worth now more than it would be if silver continued to fall; and at the same time the rupee price of his produce would be less (*i.e.* he would get now less rupees than he would have, had the price of rupee been allowed to fall with the fall of silver; in other words prices of his produce would have risen more and he would have got more money.) The Committee admitted the soundness of this argument. They, however, held that as the value of the rupee was proposed to be fixed

at or near the value then current, there could not be any sudden alteration in the prices of commodities. If however the price of silver continued to fall, there would be a difference between the price of the rupee and that of silver and the apprehension anticipated would be justified; but for such a fall the Government would not be held responsible.

The Committee also took into consideration the question whether the proposed change would put India in an unfavourable position in regard to her trade with silver-using countries. The most important of such countries in those days was China. The trade with such countries amounted to about only half of the trade with the gold-using countries, and it was, therefore on that account, essential to fix the ratio between gold and silver. It was thought that if, after the proposed changes had been carried out, (*i.e.* after the price of the rupee had been fixed) the price of silver continued to fall, this falling price would stimulate, in those countries, the production of those commodities which would compete with Indian commodities in the markets of the world, and that the effect of such increased competition would be seriously felt in India. In her trade with China, India, it was argued, would be hard hit. The Indian exports to China would be paid for by silver, and if there would be any marked difference between the prices of silver and rupee, the same silver price would mean a lower rupee price. This lower rupee price would mean a fall in the prices of commodities, which was likely to lead to a contraction of business. But the Committee held that as the Indian produce would be paid for by Chinese exports to other countries, China would be able to pay a higher silver price to India, as China would receive more silver for the same amount of gold, provided the gold price of these commodities did not fall.

It was also suggested that, owing to the fall in the price of silver, China, Japan and other silver-using countries would get more silver for that amount of produce for which they received less; and this higher silver price would stimulate the production of those articles which they formerly used to import from India. In the case of China, it was believed that no such sudden change in the economic conditions was possible owing to the sluggish and conservative nature of the Chinese and to certain impediments that were imposed on Chinese industrial enterprise, *viz.*, want of railways and other means of communications, the heavy duties on imports, etc. Japan, however, was more progressive and active, and it was feared that Japan would receive a new stimulus in the production of cotton goods which she had been producing for some years past. But as stated already, a fall in the value of money would bring about a corresponding change in the prices of commodities; and as soon as that adjustment would be brought about, the stimulus would cease to operate. It is only in the interval that the stimulus generally works.

With regard to India's opium and tea trade, the Committee held that not much loss was likely to ensue if the proposed changes were carried out. The amount of opium (worth Rs. 10,000,000 annually) imported from India formed, the Committee found, only a small portion of the total consumption in China; the use of Indian opium was more or less a matter of taste and depended on its superior qualities. Again owing to want of communication and other industrial impediments, it was hoped that China would fail to take advantage of the falling exchange. Under these circumstances, the Committee thought the opium trade of India would not suffer much. In the case of tea, the Committee held that though there was a little

chance for Ceylon and China to capture India's markets for a time, it was difficult to say to what extent Ceylon and China would be able to oust Indian tea from markets. From the steady growth and progress of the tea industry in India in those days, the Committee concluded that this trade would not suffer much.

The effect of the proposed change, it was feared, would tell heavily upon the export trade of India which, in consequence, might fall below her imports and would thus render the Secretary of State for India unable to sell his Council Bills; and the Indian Government would be faced with the necessity of sending silver to England at a ruinous loss. This argument has been discussed in a preceding section of this Chapter and need not be repeated here. There was little chance, as we have seen, for the export to diminish, and if it would diminish at all, it would do so only for a short time. Whether the debts could be paid by sale of Council Bills was a matter of indifference to the Indian Government; if it could not be so paid, it must be paid in some other way. India would pay the debt in the form which would suit her best.

Higher exchange. If the exchange were raised to a level, higher than the level then existing, all the objections raised against fixing the exchange at the existing rate would be applicable with greater force. The danger of spurious coins and of depreciation of the silver hoards would increase in proportion to the difference between the value of the rupee and the market value of its silver content. The trade difficulties due to a high exchange are likely to be more serious; and it would also be difficult to maintain the inconvertible token coin as a full legal tender at par value.

The Committee then referred to the effects which a high exchange was likely to have on prices, taxation and other fixed burdens. A high exchange means less

rupees and fall in prices. This fall in prices would sooner or later be accompanied by reduction in money wages and increase in the burden of taxation and other fixed payments; in other words, money wages would fall but the people would have to pay the same amount of tax and other fixed dues. From these considerations, the Committee concluded that to close the mints for the purpose of raising the value of the rupee, was open to more serious objections than to do so for the purpose of preventing a further fall in the value of the rupee.

Alternative Schemes

Several alternative schemes were put forward, with a view to prevent any further fall in the value of the rupee and at the same time meet the deficit in the budget. The one which the Committee considered at some length was the imposition of duty on silver, either in the form of an increased seignorage on the coinage of rupee or in the shape of a duty on all imported silver. Such an action, it was believed, would raise the value of silver and at the same time add to the revenue of the Government. The Committee held that a fixed seignorage would be of no avail; it would only increase the price of silver by the amount of the seignorage. If the price of silver fluctuated, the seignorage would be no remedy as the seignorage would not be able to stop the fluctuation. A seignorage varying inversely with the gold value of silver, rising as the value would fall, and falling as the value would rise, might prevent either a further fall or a further rise; but the task of determining the amount of the seignorage, from the practical point of view, was a very difficult one and could hardly be accomplished with any degree of success. Further the amount of seignorage would artificially increase the value of silver above its intrinsic value, a thing the Government of India intended to do by closing

the mints against the free coinage of silver. Further such a seignorage might reduce the amount of rupees to be coined. As a mode of raising revenue, this method was unsatisfactory; it could raise very little money. A 10 percent. seignorage on the annual coinage, since 1875, would produce only Rs. 600,000; if the amount of rupees coined were to fall in consequence of the imposition of the seignorage, the income would be still less. A duty on imported silver would be equally unsatisfactory; the arguments put forward just now would apply with equal force to this process.

Recommendations of the Committee

Having considered the Government scheme, the Committee made certain recommendations. In doing so the Committee had in view two objects: (1) that any scheme which might be recommended to and adopted by the Government of India should not suddenly and considerably, for the reasons stated above, raise the price of silver. If the closing of the mints would raise the exchange suddenly, it would be difficult to maintain the value of the rupee at a high level. (2) Again if the prices were to fall suddenly, owing to the rise in the value of the rupee, Indian industrial conditions would be very much disturbed. The Committee, therefore, made the following recommendations:—

1. That the mints should be closed against the free coinage of the rupee, though the Government should retain the right to coin rupees in exchange for gold at the fixed ratio of 1s. 4d. per rupee; this was the average rate of exchange of the previous two years and a half.

2. And that at the Government treasuries gold would be received at the same rate.

The Committee thus discussed the whole question, difficult and complex as it was, with great ability. They found that the situation had become embarrassing for

the Government and might become more so in future. A falling exchange, the foregoing discussion has made clear, is harmful neither to the growth of trade nor to the general prosperity of the people. A large number of witnesses deposed before the Committee that under the silver standard India had made a good deal of material progress. What was the justification for the Committee to recommend measures, intended to change radically the currency system of India? One justification was that the proposed changes were likely to end a period of suspension and anxiety, arising from a falling exchange and to remove the financial difficulties of the Government of India. There was another justification. The Committee had in view the introduction of an effective gold standard in India at an early date. The currency ideas of the people have undergone since then a radical change. An active gold currency has long been discarded as useless and wasteful. Even the gold standard stands discredited to-day. In those days, however, the ideal standard was the gold standard backed as far as possible by an active gold circulation. The recommendations they made, were not final but provisional; because the main object they had in making them, was to establish ultimately an effective gold standard in India. The Government of India wanted it, and they too held that gold standard would be beneficial to the country.

Government Action

The Government of India approved of the recommendations and to carry them into effect, passed the Act VIII of 1893, "to amend the Indian Coinage Act, 1870 and the Indian Paper Currency Act, 1882." This Act provided for the closing of the mints to the free coinage of both gold and silver, Government retaining their power to coin silver rupees on their own account. They also issued three *notifications* by which arrange-

ments were made for the: (1) receipt of gold at the Indian Mints at the rate of 16*d.* per rupee, (2) receipt of sovereigns and half-sovereigns in payments of sums due to the government at the rate of Rs. 15 for a sovereign, and (3) issue of currency notes to the Controller-General in exchange either for British sovereigns or half-sovereigns, at the above rates or for gold bullion at a corresponding rate.

By virtue of this Act and the three notifications, the rupee remained the standard of value in India, though it ceased to be the standard coin in the true sense of the term. Further, gold was not made legal tender in India though the Government of India would receive gold in payment of public dues. There was no legal relation between rupees and gold, though the Government declared that they would give rupees in exchange for gold at a certain fixed ratio, *viz.*, at 1*s.* 4*d.* *But there was no obligation on the part of the Government to pay gold in exchange for rupees.*

This was a serious defect which escaped unnoticed at that time. But if the gold value of the rupee was to be maintained at a fixed parity, two things are necessary. Firstly, gold coin and gold bullion were to be *received* in exchange for a fixed number of rupees. Secondly, gold bullion and gold coins were to be *given* also in exchange for rupees. This mistake was found out in 1907-08, when for the first time since 1899, owing to an unfavourable balance of trade, the exchange fell below 1*s.* 4*d.* Whenever balance of trade turns against India, the latter country sends gold abroad to pay for the excess of its imports over the exports. Indian merchants require gold; and this demand for gold raises its price in terms of silver, or in other words, the price of the rupee falls in terms of gold. In this case if the Government gives gold to the people in

exchange for rupees, the balance of trade may be turned in favour of India. In the first place, the amount of rupees with which gold will be bought will be withdrawn from circulation; currency would be contracted and prices will be lowered. Lower prices will stimulate export and check the imports. Secondly if more gold is put into circulation and rupees withdrawn, the price of the rupees will tend to rise. Thus the sale of gold corrects the exchanges.

Continued fall of Silver from 1893-95.

In spite of the closing of the mints the exchange, contrary to all expectations, continued to fall till 1895, with a temporary rise immediately after the Mints were closed. After the closing of the mints, the exchange rose suddenly from $14\frac{1}{2}d.$ to $16d.$ The rise was temporary and speculative and could not be maintained. The following table will show the imports of silver, the price of silver and the rate of exchange from 1893 to 1900.

IMPORTS AND PRICE OF SILVER AND THE
RATE OF EXCHANGE FROM 1893 TO 1900

Years.	Net imports of Silver into India.	Price of Silver per ounce.	Average rate of Exchange.
1893	45,529	$39\frac{13}{16}d.$	14·985 <i>d.</i>
1894	54,329	$35\frac{5}{8}d.$	14·546 <i>d.</i>
1895	27,040	$28\frac{15}{16}d.$	13·100 <i>d.</i>
1896	27,018	$29\frac{7}{8}d.$	13·638 <i>d.</i>
1897	25,929	$30\frac{3}{4}d.$	14·450 <i>d.</i>
1898	44,285	$27\frac{9}{16}d.$	15·406 <i>d.</i>
1899	23,165	$26\frac{15}{16}d.$	15·978 <i>d.</i>
1900	18,646	$27\frac{7}{16}d.$	16·067 <i>d.</i>

The table shows, in the first place, that the exchange from 1893 continued to fall till 1894 and from 1895 it began to recover until it reached 1*s.* 4*d.* in 1898. In the second place, the table shows that the price of silver continued to fall till 1899. In the third place, the imports of silver in 1893 and 1894 were much heavier than in the subsequent years. The fall in the price of silver was aggravated by the

repeal of the purchase clause of the Sherman Act in November, 1893. The heavy import of silver was accounted for by the refusal of the Secretary of State to sell Council Bills at the market rate. The Government, in spite of the provisions that the rupee was equivalent to 1s. 4d., sold at first Council Bills at less than 1s. 4d. which was the market rate. This action of the Secretary of State roused severe criticism and a storm of indignation; it was believed that the Government could not raise the rate of exchange. The demand for Council Bills fell; and the Secretary of State had to curtail his sales. The Secretary of State consequently could not sell his Bills to the full amount, and the foreign merchants had to send silver to pay to their Indian creditors.

From the table we find that the closing of the mints was followed by two very significant facts, *viz.*, huge imports of silver and a continued fall in the price of silver. Over and above, it was believed that there was much redundant silver currency at the closing of the mints.

Rise of Exchange from 1896 to 1900

From the year 1895, however, the exchange began to rise slowly and steadily (see table at page 66); in 1900 it touched 1s. 4d., the rate recommended by the Herschell Committee. This rate of exchange was maintained, with a little break in 1907-08, for 18 years from 1900 to 1917. The next thing to notice is that in 1900 the rupee became a token coin; the value of its silver content became less than the value of the coin. The token character was brought about by a fall in the price of silver and by a rise in the gold value of the rupee. This is illustrated by the table below:—

Years.	Price of Silver per ounce.	Intrinsic value of the rupee or Silver Rupee.	Average rate of Exchange.
1892	...	1s. 3 $\frac{1}{4}$ d.	1s. 3 $\frac{1}{4}$ d.
1893	39 $\frac{13}{16}$	1s. 1 $\frac{5}{8}$ d.	1s. 3 $\frac{1}{8}$ d.
1894	35 $\frac{5}{8}$	0 11 $\frac{1}{8}$ d.	1s. 1 $\frac{1}{2}$ d.
1895	28 $\frac{15}{16}$	0 11 $\frac{3}{8}$ d.	1s. 1 $\frac{3}{8}$ d.
1896	29 $\frac{7}{8}$	0 11 $\frac{7}{8}$ d.	1s. 2 $\frac{1}{2}$ d.
1897	30 $\frac{3}{4}$	0 10 $\frac{1}{2}$ d.	1s. 3 $\frac{1}{4}$ d.
1898	27 $\frac{9}{16}$	0 10 $\frac{3}{8}$ d.	1s. 3 $\frac{7}{8}$ d.
1899	26 $\frac{15}{16}$	0 10 $\frac{7}{8}$ d.	1s. 4d.

This rise in exchange was due, according to Mr. Findlay Shirras, to the following causes:—(1) decrease in rupee circulation, and (2) increase in the volume of trade. The following table brings this out clearly:—

Years	Rupee circulation in crores	Active note-circulation in crores	Clearings in crores	Total in crores	Index No. of growth of Business	Rate of Exchange
1893	136 (100)*	19 (100)	146 (100)	301 (100)	105 (100)	14'546
1894	140 (103)	17 (86)	158 (108)	315 (104)	110 (105)	13'100
1895	138 (101)	19 (98)	176 (120)	334 (110)	109 (104)	13'638
1896	134 (99)	20 (103)	181 (124)	335 (111)	107 (102)	14'450
1897	133 (98)	19 (96)	191 (130)	343 (113)	124 (118)	15'406
1898	135 (99)	18 (92)	176 (140)	329 (109)	128 (122)	15'978
1899	132 (97)	20 (105)	203 (138)	355 (118)	131 (125)	16'067
1900	133 (96)	22 (113)	210 (145)	364 (121)	146 (139)	15'973

*The figures in brackets indicate index-numbers.

Looking down the table given above we notice that immediately after the closing of the mints the active rupee circulation rose from 136 crores to 140 crores. It decreased in 1895 and though it increased a little in 1898, it fell again in 1900. In the period between 1893 to 1900 though the active rupee circulation decreased by about 4 percent or 6 crores, the volume of trade during the same period increased 39 percent. Even if the circulation of currency notes and the amount of cheques passing through the clearing-houses be included, the total shows an increase of about 21 percent against an increase of 39 percent in the volume of business. Lastly when the circulation increased from 127 crores in 1890 to 136 crores in 1893, the exchange fell from 18*d.* to 15*d.* In 1893, 1894 and 1895 when the circulation increased further, the rate of exchange fell to 14*d.* From 1895 the circulation decreased and the volume of trade increased, with the result that the exchange rose to 16*d.* in 1899.

In 1897 the Secretary of State asked the opinion of the Government of India as to whether the Indian mints were to be reopened to the free coinage of silver and gold, if the mints of France and the United States were also opened. The Government of India, however, held that it would be extremely unwise to open the mints at a time when stability of exchange was being obtained by their own isolated and independent action. This view was accepted by the Secretary of State. At the same time the mercantile communities were also anxious for the termination of the transitory period. The Bengal chamber of commerce, for example, in its despatch said that the period of transition should not be unnecessarily prolonged and that the opportunities for speculation in exchange, of which the fullest advantage was being taken, should be reduced or removed.*

The only other fact worth noting was the strin-

* Findlay Shirras, Indian Finance and Banking, page 170.

gency felt in the Indian money market during this period. The rate of interest rose high ; and it was held by many that this rise was due to the closing of the mints and the consequent shortage of money. With a view to relieve this stringency an Act (No. 11 of 1898) was passed, empowering the Government of India to direct, by order notified in the Gazette of India, to issue currency notes in India against the gold received by the Secretary of State for India in London. This Act which was to remain in force for six months was extended for two years by the amending Act, No. VIII of 1898.

CHAPTER V

Fowler Committee, 1898

In 1898 when the second commission was appointed to enquire into the currency system of India, the position, as explained already, stood thus:—

(1) The rupee was unlimited legal tender; but it was a token coin with its face value greater than its intrinsic value.

(2) Mints were closed against the free coinage of silver and gold, Government retaining their power to coin rupees on their own behalf;

(3) Gold was not a legal tender;

(4) There was no legal relation between gold and silver; and

(5) Finally the Government received gold and sovereign at a fixed rupee price in payment of public dues, but did not give any gold for rupees.

Currency Committee of 1898

In 1898 the Government of India proposed to take, in the light of their experience, several steps to stabilise the value of the rupee and to introduce ultimately an effective gold standard in India. This committee which was presided over by Sir H.H. Fowler and is known as the Fowler Committee had to go over a part of the ground covered by the Herschell Committee. The Committee was, among others, to recommend measures which might lead to "the establishment of a satisfactory system of currency in India, and for securing, as far as practicable, a stable exchange between that country (India) and the United Kingdom."

Silver Standard

It was urged before the Committee by some—the number of such people had dwindled much by 1898—that the Indian mints should be reopened to the unrestricted coinage of silver. The arguments adduced in favour of this suggestion were: (1) A low rupee and a low exchange would encourage the export trade of India on which, they pointed out, depended the prosperity of India, whereas an arbitrarily enhanced rupee (that was the case then) had discouraged exports; and put India in a disadvantage in her trade with the silver-using countries; (2) the closing of the mints had caused a stringency in the Indian Money Market, particularly in 1898.

With regard to the second point, the Committee found that the closing of the mints had no special effect on the rate of interest. Though the rate of interest of the Bank of Bengal (there was no Imperial Bank in those days) rose on the 24th February, 1898 to 12 per cent, the rate in the business season of 1898-99 never exceeded 7 per cent. One reason of the high rate of interest in 1898 was the failure of the Secretary of State for India to sell his Council Bills and Telegraphic Transfers on account of the depletion of the balances of the Government of India, brought about by heavy expenditure on famine relief and military operations and by a falling revenue. Usually by the sale of Council Bills and Telegraphic Transfers, the nature and importance of which will be discussed more fully in the next chapter, a large amount of money is released from the government balances and placed at the disposal of the Indian Market, thus removing the stringency of the money market to a certain extent. The Committee also pointed out that a high rate of interest was not unknown to India under the system of open mints.

With regard to the first point, the Committee agreed with the Herschell Committee. The silver-using countries, in consequence of a fall in the price of silver, might get more silver for their exports and thus were likely to expand their production. The same amount of export would now, as before, sell for a fixed gold price; but a fixed gold price would now bring a larger amount of silver than before. But such an expansion would be transitory, as eventually interest and wages would rise and adjust themselves to the high prices, and the elements of profit would no longer exist. Further statistics did not lend any support to this theory. From these facts and reasons the Committee held that they did not support the theory that a high price of silver would check exports permanently.

The table below shows that a low exchange does not always stimulate exports; similarly a high exchange is not always accompanied by large imports. This was exactly the finding of the Herschell Committee whose decision was quoted by the Fowler Committee with approval.

Year.	Exchange.	Price of Silver per ounce.	Exports of Merchandise (in thousands.)
	<i>d.</i>	<i>d.</i>	Rs.
1887-88	16·898	44 ⁵ / ₈	90,471
1888-89	16·379	42 ⁷ / ₈	96,978
1889-90	16·566	42 ¹¹ / ₁₆	103,797
1890-91	18·089	47 ¹¹ / ₁₆	100,136
1891-92	16·733	45 ¹ / ₁₆	108,036
1892-93	14·985	39 ¹³ / ₁₆	106,448
1893-94	14·547	35 ⁵ / ₁₆	106,448
1894-95	14·101	28 ¹⁵ / ₁₆	108,815
1895-96	13·638	29 ⁷ / ₈	114,263
1896-97	14·451	30 ³ / ₄	103,914
1897-98	15·354	27 ⁹ / ₁₆	97,537
1898-99	15·978	26 ¹⁵ / ₁₆	112,723

With regard to the tea-industry, the Committee held that, owing to a fall in the price of silver, China, a silver-using country, had received more silver for tea than India had. From actual facts, however, the Committee

found that the export of China tea had not appreciably increased and that there was a rise in Chinese wages and general prices which had certainly offset the gains from a high price-level. In this connection the Committee quoted with approval the opinion of the Government of India, contained in a letter written in 1892 to the Honorary Secretary to the Darjeeling Planters' Association. The following extract from that letter sums up the view of the Government:—

(1) That a country, as a whole, makes no gain in its international trade by a depreciation of its standard, since the extra price received for its exports is balanced by the extra price paid for its imports.

(2) That the producer of an article of export may make a temporary and unfair gain from depreciation of the standard at the expense of his employees and of other persons to whom he makes fixed payments.

(3) But that this gain, while not permanent, is counterbalanced by a tendency to over-production and consequent reaction and depression, by a liability to a sudden fall in prices as well as to a rise, and by the check to the general increase of the international trade which necessarily results from the want of a common standard of value between countries which have intimate commercial and financial relations.*

If a low exchange would stimulate exports, the Committee argued, the lower the exchange, the better. Should the exchange be allowed to fall as low as possible?

After taking these considerations into account, the Committee held that the opening of the mints to the free coinage of silver would lead to an instability of exchange, which, as past experience has shown, was sure to do incalculable harm to the true interests of the country. Over four-fifths of India's foreign trade

* See Herschell Committee's Report, par. 27.

was with the gold standard countries, and a stable exchange with such countries would be of very great advantage to India.

The effect of an unstable exchange on the finances of the Government of India would also be disastrous. A little fall in the price of silver would necessitate heavy taxation which, in the opinion of Lord Northbrook, would be unwise in the highest degree. The uttering of a large number of counterfeit coins, an apprehension entertained at the time for the reasons stated on page 54, had not taken place on any appreciable scale.

In view of these facts the Committee accepted the view of the Government and held that India should not revert to silver standard.

Gold Standard

If India was not to revert to silver standard, the practicable alternative, the Committee held, was a gold standard either with a gold currency or a gold reserve. As already stated four-fifths of the Indian trade was with gold standard countries, and, for that reason alone, in the opinion of the Committee, a gold standard would be of very great advantage to India. The importance of gold in international commerce was emphasised by Dr. Marshall in the course of his evidence before the Committee. The introduction of gold standard in India was "like a movement towards bringing the railway gauge on the side branches of the world's railways into unison with the main lines." A gold standard would be the most effective means to attract capital in India which was very much needed in the busy part of the years. During that part of the year, owing to a heavy demand of money for moving the crops, the rate of interest generally rose very high. Moreover it was necessary that money should flow out when not required

and flow in when required without any depreciation, and this could only be achieved, in their opinion, by adopting gold standard in India. To develop also her natural resources foreign capital was very much needed in India. Such capital could only come from gold standard countries which were willing to invest money in Indian industrial enterprises, provided they were assured of a steady exchange.* This was the opinion of Mr. Alfred de Rothschild, a banker of wide experience, and the Committee attached very great weight to his testimony.

The Committee also found that on the 31st of March 1898 a considerable amount of gold had accumulated in the Paper Currency Reserve, the amount was over £2,000,000. The Secretary of State for India, too, had been able to sell a considerable amount Council Bills in 1899 in excess of his own requirements at 15·978*d.* per rupee, almost at the exchange fixed in 1893 (16*d.* per rupee). These facts would show that there had been practically speaking a gold standard in India since 1893 and also a gold reserve. If this could be done in a period of transition, much more, the Committee argued, could be done in future with the growth of confidence. It was evident that the Government could not receive gold beyond a certain limit, unless they were empowered to pay the gold out again either in cashing their notes or paying their liabilities. But, if they were allowed to do so, gold would become a legal tender at a fixed rate and the provisional steps, taken in 1893†, would end. The question was whether the provisional steps should end now and gold declared a legal tender, or more time should elapse and more gold accumulate before the provisional steps were to be superseded. The Committee were of opinion that as the Government of India had

*See page 48.

†See page 63.

publicly announced their willingness to take active steps for the early establishment of a gold-standard and a stable exchange, no time should be lost in establishing a gold standard in India. If that was not done, there would be doubts in the minds of the people, rumours would arise of a possible change of currency policy and the material interests of India would suffer from the withdrawal of confidence in her monetary future. For these reasons the Committee urged the necessity of establishing an effective gold standard without loss of time.

Government Proposals.

The Committee then proceeded to discuss the specific proposals made by the Government of India. The proposals may be summed up as follows:—(1) About two crores and a half of rupees should be withdrawn from circulation to raise the value of the rupee to 1s.4d. (2) Money should be borrowed in England and sent to India to form the nucleus of a gold reserve in India and to that sum was to be added gold purchased with the bullion obtained from the melting of the rupees and (3) Government should not part with their gold until the value of the rupee was raised to 16d. and sovereigns had become current coins. These proposals of the Government of India were contained in a despatch written on the 3rd March, 1898, when exchange was still fluctuating, causing trouble both to the Government of India and the mercantile community. All that the Government wanted was to keep the exchange value of the rupee steady at 16d. The proposals, outlined above, were intended to raise the exchange value of the rupee to that point. It was believed that by melting down the rupees and thus decreasing the rupee circulation, the exchange would be pulled up. So long as the exchange value would remain below 16d. the Government proposed to take

rupees from their balances, melt them down, sell the bullion for other rupees, pay these rupees into their balances, and make good the loss (40 percent) with a part of the borrowed gold. It was also a part of their scheme that, until the exchange value of the rupee had been raised to 16*d.* and sovereigns had become a permanent part of the currency, they should not part with gold. Meantime gold was not to be made legal tender in India, though the Government intended to make it so in future.

The proposals of the Government were based on the assumption that the rise in the exchange value of the rupee since 1893 was brought about by a contraction of currency. The Committee hesitated to accept the view that the contraction of currency had raised the value of the rupee. Though the rupee had appreciated since 1893, this appreciation was due to various causes including contraction of the currency; such causes were large borrowing in England on behalf of India, reduction of the drawings of the Secretary of State for India, an increase in exports and a general rise in gold prices. Another reason, according to the Committee, was the reduction in the imports of silver in India. The Committee held that it would not be safe, in view of these facts, to base any action on the assumption made by the Government of India, namely, that contraction would raise the exchange. On the contrary the Committee held that if the rise in the value of the rupee was not due, either wholly or mainly, to the contraction of currency, a further contraction might not raise the value of the rupee. The Committee, however, did not dispute the correctness of the theory that the value of the rupee depended on the amount in circulation; but they held that the effect of the reduction might not be direct and immediate. Further they feared that a heavy contraction might

create stringency in the Indian money market. The Committee, for the reasons stated above, could not accept the Government proposals, though they held that there should be gold standard in India.

A Gold Currency.

The next question which the Committee had to decide was whether there should be gold standard *with or without a gold currency*. The Government favoured a gold standard with a gold currency. In this connection the Committee considered the scheme of Mr. Lesley Probyn who laid special stress upon the hoarding habit of the people of India and held the view very strongly that a gold currency would only encourage this habit. He accordingly proposed: (1) that a new Government note of the denomination of Rs. 10,000 should be issued, (2) that such notes were to be issued in exchange for gold and payable either in gold or silver at the option of the holder and (3) that the currency department might pay gold when it would be demanded either in sovereigns or gold bars of not less than £67. It was hoped that this scheme would attract gold to India and that a gold reserve would gradually accumulate which would enable the Government to convert all rupees and rupee-notes into gold when presented in parcels of not less than Rs. 10,000. The idea of Mr. Probyn was to keep rupees in currency and make gold available generally for international payments. The Committee declined to accept this proposal for two reasons. Firstly, bullion had never been used as an international currency, and, secondly, they held that it was unusual for the standard metal to pass from hand to hand in the form of a current coin. The Committee also could not accept the view that a gold currency would encourage the hoarding habits of the people. They pointed out there was no likelihood in near future

of putting a stop to the import and absorption of gold by India. Even under silver mono-metallism India imported and absorbed gold and would go on doing so in future, no matter what the currency system might be. Further the Committee pointed out that gold coins were in common circulation in India not long ago and were the principal currency in Madras till 1806. "If hoarding did not," the Committee concluded, "render a gold circulation an impossibility in the past, we look for no such result in the future." We support this view and are inclined to think that Mr. Probyn, like many other English critics, made too much of this hoarding habit. People of India might have hoarded in the past, but what the critics always fail to understand is that with the disappearance of the causes that led them to hoard, the habit is sure to be shaken off.

Another scheme of a similar nature for establishing a gold standard in India without a gold currency was placed before the Committee by Mr. A.M. Lindsay. Mr. Lindsay proposed that to fix the sterling exchange (*i.e.* price of rupee in sterling) drafts were to be sold in India, encashable in London in sterling from a fund to be created for the purpose, and similarly drafts were to be sold in London encashable in India in rupees; the sterling would be convertible into rupees in India at $16\frac{1}{4}d.$ per rupee and rupees to be converted into sterling in London at $15\frac{3}{4}d.$, *i.e.*, between the gold points. In order to meet sterling drafts, more often called the Reverse Drafts, sold in India on London, a loan was to be raised in London; and for encashing the rupee drafts, better known as Council Drafts, sold in London on India, the available stock of rupees might be increased by the purchase of silver in England. The rupee, under this scheme, would retain its token character and continue to form the circulating medium; gold should not be legal tender.

Both these two plans aimed at establishing a gold standard without a gold currency; gold was to be given only for making international payments, and rupee was to remain the legal tender in the country. Such a standard is called the exchange standard.* Lindsay's scheme was severely criticised both by the Government officials and leading financiers. Such eminent persons as Lord Rothschild, Sir John Lubbock (Lord Avebury, Sir Samuel Montagu (the late Lord Swaythling) in the course of their evidence before the Committee said that any system without a visible gold currency would be looked upon with disgust. The Committee took this view into account, rejected both the schemes and favoured a gold standard with a visible gold currency. They thought that the exchange standard would check that flow of capital into India which was so much needed for the development of the resources of India.

Recommendations

The Committee rejected such a standard and recommended gold standard with a gold currency. The recommendations were:—

(1) That the British sovereign should be made a legal tender and a current coin in India.

(2) That the Indian mints should be thrown open to the unrestricted coinage of gold on terms and conditions such as governed the three Australian Branches of the Royal Mint.

The Committee made those recommendations with the hope that India might have an effective gold standard and currency in the near future. That way lay India's industrial prosperity.

The Rupee

The most important and vexed question which

*See Chapter VII.

confronted every Currency Committee in India was what would be the position of the rupee under gold currency. The Committee suggested that under an effective gold standard rupees would be only token coins. The question was whether they should remain unlimited legal tender as they were then. The Committee considered the position of the silver coins in England, France and the United States. In the case of England silver shillings were legal tender upto 40s. only. These silver shillings were coined by the Government on their own behalf and the total issue was always limited: it was on this limitation of the total issue that their value depended. By law they were not convertible into gold. In France the five-franc piece, an unlimited tender for all internal purposes, was as good as gold. Similar was the case with the American dollar. Both in France and America the mints were closed to the coinage of silver. They have not been coined in France since 1878 and in America since 1893. In neither country they were convertible legally into gold; in both the countries they were as good as gold for all internal purposes. For international purposes, however, both of these countries used gold.

With these cases before them the Committee recommended that the rupee should remain unlimited legal tender and inconvertible into gold. The amount of rupee circulation was very large. The imposition of an obligation on the Government to convert all rupees into gold was a serious liability which, in their opinion, should not be accepted by the Government. They further held that though the Government should not issue gold coins for internal purposes, they should use them freely for foreign remittances whenever the exchange would fall below the specie point.* They also suggested that when sufficient amount of gold had

*See Chapter II.

accumulated and so long as it was available, they might discharge their obligations even in India in gold, instead of in rupees. The Government were to retain their exclusive power to coin fresh rupees and to give rupees for gold; but no fresh rupees should be coined until the proportion of gold in the currency would exceed the requirements of the public. The Committee also recommended that any profit from the coinage of rupees should be set apart as a special reserve, apart from the Paper Currency Reserve and the Ordinary Treasury Balances. The full value of the rupee being much greater than its intrinsic value, the government always gain in coining it. The rupee contains $\frac{2}{3}$ oz. of silver of eleven-twelfths fineness.† When standard silver sells at 24*d.* per oz., the cost of a rupee to the Government is about 9·181*d.* The average rate of profit on coinage of rupees from 1910 to May 1912 was about 42 per cent of the nominal value.‡

The majority of the members (nine out of eleven) recommended that the value of the rupee should be fixed at 16*d.* Their reasons were as follows:—

(1) This rate had been steady from January 1898.

(2) In 1898-99, at this rate, the total volume of export trade amounted to Rs. 120,000,000, a figure which was never attained in the past.

(3) Prices and trade had adjusted themselves to the rate recommended.

The Government accepted these recommendations and passed the Indian Coinage and Paper Currency Act (XXII of 1899) which made sovereigns and half-sovereigns legal tender at Rs. 15 and 7½ respectively. A Gold Standard Reserve was also created, and attempts were made to open the mints to the free coinage of gold coins and to put them into circulation. This part of our story is related in the next Chapter.

† Keynes, Indian Currency and Finance, Chapter III, p. 37, footnote.

‡ Keynes, Indian Currency and Finance, Chapter III, p. 37.

CHAPTER VI

1898 to 1914.

A Review.

Let us review now the position as it stood in 1899. Briefly stated the position was thus:—

(1) The rupee remained the standard of value; it could be minted by the Government only and its price was fixed at 16 *d.* which was much greater than the value of the silver in a rupee;

(2) Sovereigns and half-sovereigns became unlimited legal tender at Rs. 15 per £.

Thus India adopted gold-standard without a gold currency. The rupee remained the most important currency for internal purposes, and gold was to be used more for external than for internal purposes. The Government undertook to maintain the price of the rupee at 16 *d.* and, to enable them to do so, the Fowler Committee recommended the establishment of a Reserve which came to be called later 'the Gold Standard Reserve.' From this reserve gold was to be issued whenever the price of the rupee tended to fall below 16*d.*

The question of maintaining the price of the rupee at a fixed ratio with gold does not arise in the case of internal transactions. Within the country the rupee is the standard of value and, for all practical purposes, the standard coin. It is with its value that the value of other things are compared. In buying or selling an article neither the buyer nor the purchaser ever thinks or need think of the gold price of the rupee; to him it matters little whether a rupee will fetch him 16 *d.* or 18 *d.*

But the question of maintaining the gold price of the rupee assumes very great importance in case of international payments. The reader knows that outside India rupee is not the standard of value which in most cases is gold. There silver is sold as an ordinary commodity, its price varying with a change in the conditions of its demand and supply. When an Indian buys his merchandise from England or America, he has to pay his price in gold as these two countries are on a gold basis (at present England is not on a gold basis); similarly when an Englishman or an American buys from an Indian producer, he has to pay in silver. It is in such transactions that the question arises how many rupees are equivalent to the American dollar or English sovereign. We have noticed that the same question arose in 1893 in another connection. We have discussed at length the disadvantages of a varying exchange and the necessity of maintaining a fixed price of rupee.* Had all the countries been on a silver basis as India, this question would not have arisen; it will not arise if India is placed on a gold basis in future.

How the gold value of the rupee was maintained at 16 *d.* will be discussed in the next chapter.

Attempt to Mint and Circulate Gold in 1900.

We will narrate now briefly the development of the currency till the year 1914 when the third Commission was appointed to enquire into it. In 1900 the Government of India, in pursuance of the recommendation of the Fowler Committee, decided to constitute a branch of the royal Mint at Bombay, and at the same time an attempt, though half-hearted, was made to force sovereigns into circulation. But the Mint could not be opened owing to the most unreasonable attitude of the

*See Chapter IV.

British Treasury. At first it raised a number of technical difficulties in a spirit of open hostility to the whole proposal. And when a scheme, acceptable to the Mint in England and the authorities in India, was formulated, the Treasury officials once more came out with grandmotherly affection and raised the question of the wisdom of such a policy from the Indian point of view. The following extract taken from a letter written to the Secretary of State for India by the Treasury officials will show their attitude:—

While expressing their satisfaction that an agreement has now been reached, my Lords think it desirable, before practical steps are taken to carry out the scheme, to invite Lord George Hamilton to review the arguments originally advanced in favour of the coinage of the sovereign in India and to consider whether the course of events, in the two years which have elapsed since the proposal was made, has not tended to diminish their force.....The gold standard was now firmly established and the public requires no proof of the intention of the Indian Government not to go back on their policy which is beyond controversy. Sovereigns are readily attracted to India when required under existing conditions.....On the other hand the estimates of the Government of India of gold available for coinage in that country (India) are less than was anticipated.....The staff would have to be maintained in idleness for a large part of the year at considerable loss to the Indian exchequer.

The India Office, it must be said to its credit, refused to subscribe to this view and replied thus:—

The establishment of a mint for the coinage of gold in India is the clearest outward sign that can be given of the consummation of the new currency

system.....His Lordship is not inclined to abandon the scheme which it has now reached.

The Treasury's reply which has been characterised as cogent was:—My Lords cannot believe that the position of the gold standard will be strengthened or public confidence in the intentions of the Government confirmed, by providing machinery for obtaining gold coins which are neither demanded nor required by the mercantile community.

The Secretary of State for India had to agree to the indefinite postponement of the scheme. Thus the scheme had to be dropped owing to the opposition, the nature of which was, to say the least, most unreasonable and unwarranted, of the Treasury officials whose knowledge of Indian affairs and sentiments was entirely wrong. All the recommendations of the Fowler Committee, as the reader remembers, aimed at the establishment at an early date of an effective gold standard in India. They thought, and rightly so, that an effective gold standard would not only obviate many of the financial difficulties which India had to face but would also ensure her future progress and commercial activities. This is only one part of the story we have to relate. The other part is equally disappointing.

When these attempts were being made to open the Mint to the coinage of gold, the Government made also an attempt to put sovereigns into active circulation. Notwithstanding that sovereigns and half-sovereigns were legal tender, demand for rupees continued unabated. The Government to meet this heavy demand for rupees had to think seriously, for the first time since 1913, of coining rupees. The Gold Note Act of 1898 which empowered the Government to issue notes or rupees against gold tendered in London added to this strain on rupees. The gold reserve, however, went on swelling rapidly as the table below shows:—

Year	(In lakhs)	
	Gold	Silver
April, 1899	3,25	14,62
November, 1899	5,56	10,84
January, 1900	7,59	6,99
March, 1900	10,83	4,96
July, 1900	12,82	7,04

With such a heavy stock of gold, the Government began to put gold into circulation. The coins, however, came back to the Treasury balances and increased the stock of gold in the reserve. A famine broke out at this time. To help the people, the Government made temporary advances from the Treasury balances. The rupee balances fell very low and the Government coined $6\frac{1}{2}$ crores of new rupees in the first six months of 1900. In March 1900 the government made a more vigorous attempt to put gold into circulation. The currency offices were instructed to give sovereigns in exchange for notes, and Post Offices and other institutions under the Government were also instructed to put sovereigns into circulation. The results, in the words of the Chamberlain Commission, were unsatisfactory; many of the gold coins came back to Government offices and the Government found themselves unable to cash currency notes in several places. Sovereigns also, it is said, went to a discount of as much as 4 annas in many places; there was also a heavy demand for rupees. Famine conditions which made a heavy demand for rupees aggravated the monetary stringency. In these circumstances the Government resumed the coinage of rupees on a considerable scale in 1900 and gave up for the time being the attempt of forcing gold into circulation.

From 1903 to 1910 little was heard of any proposal for an active encouragement of the circulation of gold; the intention of having an active gold standard, how-

ever was not altogether given up. In the Budget debate of 1910, Sir James Meston, (now Lord Meston), then Financial Secretary to the Government of India spoke as follows* :—

The broad lines of our action and our objects are clear and unmistakable, and there has been no great or fundamental sacrifice of consistency in progress towards our ideal. Since the Fowler Commission that progress has been real and unbroken. There is still one great step forward before the ideal can be reached. We have linked India with the gold countries of the world, we have reached a gold exchange standard, which we are steadily developing and improving. The next and final step is a true gold currency.

One year later, in March 1911, Sir Guy Flatwood Wilson, Finance Member to the Government of India, in reply to Sir Vithaldas Thackersey who suggested the introduction and minting of a new 10-rupee gold coin, said that "much has happened since 1902 which justifies the reopening of the question". In a despatch to the Secretary of State, dated May 16, 1912, the Government of India proposed to open the Bombay Mint to the coinage of sovereign. The British Treasury again objected and stipulated that either the branch mint should be under Imperial management or that it should be wholly separate. In a despatch, dated October 18, 1912 the Secretary of State suggested to the Government of India that a separate gold coin of 10 rupees should be coined at Bombay. The Government accepted the proposal. This is how matters stood in 1913 when the third Commission, known as the Chamberlain Commission, was appointed to go into the whole question. In passing we may note—though it may be a little out of the place—that the Indian currency sys-

*Keynes, Indian Currency and Finance, Chap.V. page 67.

tem and currency policy have never been allowed to develop on independent lines; they have been dictated by the British Treasury officials who care more for themselves than for India.

The only criticism which we need offer is that the experiment was tried for too short a time to justify the conclusion that gold was not popular with the people. Mr. Keynes attributed "the defeat of the experiment of 1900-1901" 'to a variety of causes, but mainly to the long habituation of the Indian public to the use of silver, and to the unsuitability of the sovereign, by reason of its high value, for so poor a country as India'. * It will be enough for us to say, in reply to this criticism, that gold was in circulation in India not very long ago and that 10-rupee and 50-rupee notes formed in those days, as they do now, a very important part of our active currency. Since 1900 the Government of India have not repeated the experiment except temporarily during the war. The year 1900 may be rightly called a year of lost opportunities. Had an effective gold standard been established in that year, many of the troubles which the Government of India have experienced since then, would not have arisen at all. Moreover had the government made a more serious attempt they might have been able to put into circulation a fairly large number of gold coins. In 1925 when the same question was placed before the Hilton-Young Commission, two very serious difficulties arose. Firstly, by that time gold currency had been discarded in many advanced countries; it became a sign of backwardness. Secondly, shortage of gold and a probable fall in gold prices made it difficult for the Commission to recommend its adoption.

Gold Reserve.

It was also decided in 1900 by the Government of

*Keynes, Indian Currency and Exchange, Chap. IV, page 74.

India to form, in accordance with the recommendations of the Fowler Committee, a special reserve from the profits of the coinage of rupees. From 1901 onwards the profits of rupees were remitted to London by shipment of gold taken from the accumulations in the Paper Currency Reserve in exchange for the freshly coined rupees. This gold was invested in securities, and the interest earned on them was also added to this Reserve, then known as Gold Reserve. With the balance of trade in favour of India these stocks of sovereigns continued to increase and a difficulty arose in providing sufficient rupees to meet the Council Bills. This difficulty in meeting the demand for rupees accounted for the formation of a special branch of this Reserve in India outside the Paper Currency Reserve. From 1906 this branch of the Reserve was held in India in fully coined rupees. The cost of maintaining this reserve was charged against the Gold Reserve by the simple process of holding the profits on the coinage of rupees, in the Reserve in India instead of converting them into sterling in London. Thus it had two branches, *viz.*, the Silver Branch in India in which there were rupees, and the Gold Branch in London consisting of gold and gold securities. The Silver Branch was intended to strengthen the rupee supply and so to prevent the exchange value of the rupee going over 1s. 4d. The London Branch serves a two-fold purpose:—

(1) It enables the Secretary of State to purchase silver for coinage in India, and

(2) It supports and strengthens exchange when the balance of trade goes against India.

The profits from the coinage of rupees amounted to about £ 18,600,000 by October 1912.* A part of this, however, was diverted in 1907 for capital expenditure on railways, leaving about £ 17,500,000 for the

* Keynes, Currency and Finance, Chapter VI.

Gold Standard Reserve. On the 31st. March, 1913, the composition of the Gold Reserve was as follows:*

	£
Securities at Market value ...	15,945,669
Money but at short notice ...	1,005,664
Gold deposited at the Bank of England ...	1,620,000
Silver in Indian Branch, 6 crores at 16 <i>d.</i> ...	4,000,000
	22,571,333

Though the Gold Standard Reserve was founded in 1900, it originated from the recommendations of the Fowler Committee. They recommended, as we have seen, that the profits on the coinage of rupees should be set apart and kept in gold as a special reserve in India. In case the exchange were to fall below the specie point, gold from this Reserve should be made available for remittance abroad. For example, if the exchange tended to fall below the specie point, the Government of India were to remit a portion of the gold to London, a corresponding reduction being made in the drawing of the Secretary of State. Thus according to the suggestions of the Committee: (1) the reserve was to be kept in gold in India, and (2) it should be made freely available for foreign remittances in case of an adverse balance of trade.

But when the Gold Standard Reserve came to be established in 1900, serious departure was made from the original plan. The profits on the coinage of rupees were sent to London and invested in securities; and though the original instruction of strengthening the exchange was strictly adhered to, the method of doing so differed materially from the one suggested

* Chamberlain Commission, para 97.

by the Committee. Thus when the balance of trade turns against India and the exchange tends to fall below the specie point, the Government adopts the following two methods:—

1. The Secretary of State stops the sale of Council Bills, demand for which generally falls during such times, and thus prevents an enlargement of the rupee circulation, which the sales of Council Bills always necessitate.

2. At the same time the Government of India sells Reserve Bills in India on London. The effect of these sales is the withdrawal of those rupees from circulation with which the Bills are purchased. Thus the currency is contracted by the amount of the Reverse Bills sold to the public.

Thus by preventing an addition to the currency and actually contracting it the Indian price-level is raised and the exchange is strengthened.

*Council Bills.**

Before we proceed further in our narration, we should do well to explain the meaning and nature of Council Bills, an expression which we have had occasion to use more than once. The incident of 1907-08 will be unintelligible to a reader, unacquainted with the intricacies of the Indian Currency.

Council Bills are drafts sold by the Secretary of State for India in London for sovereigns or sterling and are encashable in India into rupees at the Government Treasuries. We have seen that from very early times, India has had to remit money to London to defray the Home charges. This money has never been actually shipped to London. What is done is this:— The Secretary of State sells in London drafts for gold, encashable in India into rupees. These drafts, sometimes

* See Chapters VII and VIII.

called rupee drafts, are purchased by English Exchange Banks and Financial houses which send them to India to be encashed into rupees. Thus the Secretary of State gets his gold by the sale of the Bills which are paid for by the Government of India in rupees. Thus the remittance of gold from India to England is effected without any shipment of either silver or gold. As India generally has an excess of exports over imports, India receives more money than she sends out. The foreign merchants send this money by buying these drafts. They buy these drafts and pay for them to the Secretary of State in gold or sterling. The Secretary of State thus gets the money he requires for his expenses. These merchants bring these drafts to India and get them encashed at the Government Treasuries. Thus the amount of money which the Secretary of State has received is paid out by the Government. The number of drafts to be sold, therefore, depends on the amount of money available in India for their encashment. The funds available in India for this purpose are the: (1) Silver branch of the gold Standard Reserve, (2) the cash balances at the various treasuries, and (3) the Paper Currency Reserve. We will discuss more fully these funds in the next Chapter. Upto 1900 the Council Bills were sold only for the purpose of meeting the Home charges. As these bills were encashable in rupees, it was of paramount importance that the gold price of the rupee should be fixed. On occasions when the balance of trade was in favour of India, and hence when there was a heavy demand for these bills, the Secretary of State for India would sell more bills than he needed for his immediate requirements. Such sales generally were more often at a higher rate of exchange than usual and this enabled the Secretary of State for India to make a little profit. These bills are in the nature of exchange bills, and hence they can only be

sold at or above par, when the balance of trade is in India's favour. When the exports exceed the imports, the countries to which exports are sent have to send money to India, and this is done by the purchase of Council Bills. When, however, the balance of trade turns against India, the latter country has to send money outside; and then there will be no demand for rupees but a demand for gold to be sent abroad. Thus a favourable balance of trade always implies a heavy demand for Council Bills *i.e.* for rupees, and is consequently, likely to raise the price of the rupee. An unfavourable balance of trade is accompanied by a fall in the price of the rupee.

Since 1900, the functions of the Council Bill system have been enlarged. As the Government of India undertook to give rupees in exchange for sovereigns at the rate of 1s.4d. per rupee, the Banks would only buy Council Bills, if they were sold at 1s.4d. *plus* the cost of sending gold out to India. This cost varied from time to time but seldom exceeded $\frac{1}{8}$ d. per 1s.4d. The Exchange Banks, therefore, were willing to buy Council Bills at a price less than 1s.4 $\frac{1}{8}$ d. per rupee; if they were sold at a higher rate, the Banks would prefer to send gold to India, a process which would cost them only 1s.4 $\frac{1}{8}$ d. per rupee. If the Secretary of State for India were to refuse to sell the Council Bills at a price less than 1s.4 $\frac{1}{8}$ d., the merchants who had payments to make in India must send their gold, present same to Government Treasuries, get rupees in exchange and pay their creditors with them. In this case gold would necessarily accumulate in the Indian Treasuries. Such accumulation might cause much inconvenience to India and the Secretary of State. In the first place silver might be required in India to be coined into rupees to meet the demand of the Banks which would present gold and get rupees in exchange. This silver is

always purchased in London. Secondly the profit on the coinage of rupees must be credited partly to the Gold Standard Reserve kept in London. For both these purposes, gold that had accumulated already in the Indian treasuries had to be shipped back to London; and this shipping back would involve the Secretary of State for India in some loss, *viz.*, the cost of sending gold to India (for the Secretary of State could probably have got 1s. 4½*d.* per rupee if he had sold his Bills, whereas when gold came to India, he could get only 1s. 4*d.*), and the cost of bringing it back to London, which is generally $\frac{3}{32}$ *d.* per rupee; thus a refusal to sell bills would

mean a loss of $\frac{1}{8} + \frac{3}{32} =$ about ¼ *d.* per rupee. Thirdly the Secretary of State might think it advisable to have gold in the Currency Reserve in London to meet a possible emergency, and this gold he could easily have by selling his Council Bills at a time, when it was profitable to do so, *i.e.* when there was balance of trade in favour of India. Lastly if the Secretary of State had considerable cash balances in India, he might sell his Bills and get his gold, thus virtually transferring the balance from India. Another function of the Council Bills was to meet the demands of trade. When the balance of trade is in favour of India, foreign merchants and Indian merchants require funds at their disposal. The foreign merchants require money to pay his Indian creditors; the Indian merchants also require money to move the crops to the ports. The sales of Council Bills place funds at the disposal of both.

Since 1925 remittance to London has been mainly made by the purchase of sterling in India, the effect of which is the same as the sale of Council Bills. Both the processes release money from the government treasuries.

and place it at the disposal of the Indian money market.

Thus since 1900, the Secretary of State for India has been selling his Bills for the purposes mentioned above. But it should be borne in mind that these Bills can only sell when there is a demand for them; and this demand depends entirely, as explained already, on the balance of trade being in favour of India. If India is to receive more than she is to send outside, the foreign merchants would buy these bills from the Secretary of State, pay him in gold, cash them in rupees in India and pay their creditors. If the balance of trade goes against India, as it sometimes does, the opposite phenomenon is likely to arise. India has to send then more money than she is to receive; and hence, in this case, there will be more demand for gold than for rupees. The gold value of the rupee will fall.

If, on account of a favourable balance of trade, there is a heavy demand for Council Bills, their price is likely to rise; but this price would not go beyond 1s. 4d. per rupee plus the cost of sending gold to India, *i.e.* 1s. $4\frac{1}{8}$ d. per rupee, as the Government of India undertook to give rupees in exchange for gold at 1s. 4d. per rupee. Had not the Government undertaken to do so, its price, in the circumstances we are contemplating, might have gone beyond 1s. $4\frac{1}{8}$ d. per rupee, but it could not go beyond 1s. $4\frac{1}{8}$ d., because the Secretary of State would always sell his drafts at 1s. $4\frac{1}{8}$ d. The upper limit of the exchange, therefore, was fixed at 1s. $4\frac{1}{8}$ d. per rupee. But no lower limit was fixed till 1907. In case of an unfavourable balance of trade, there would be a heavy demand for gold exportation, and hence the price of gold in silver, as gold is always purchased in India with silver, might rise: in other words, the price of the rupee might fall far below the statutory limit, *i.e.* 1s. 4d. Such was the case in 1907.

Reverse Bills 1907-08.

In 1907-8 a new phenomenon, hitherto unknown to the Government, occurred and for a time upset the whole arrangement of 1899. Since that year the balance of trade was always in favour of India; and the question which the Indian Government had to face was to keep down the price of the rupee at 1s. 4d. In 1907-8 there was a partial failure of the summer monsoon; close on its heels came an American financial crisis which brought a general monetary stringency all over the world. Foreign countries, having run short of money, failed to make their usual purchases from India. Indian exports fell, though imports ordered earlier began to pour in. Balance of trade turned against India, and there was a heavy demand for sovereigns to be sent abroad to pay for the imports. But the Government of India refused to give gold from the Paper Currency Reserve for exports in quantities larger than £10,000 to any one individual on any one day, but continued to give gold for internal use. As a result the exchange fell on the 23rd November to 1s. $3\frac{2}{3}$ d. per rupee *i.e.* below the specie exporting point which was 1s. 4d. $-\frac{3}{2}$ d. = 1s. $3\frac{2}{3}$ d. The Secretary of State then withdrew from the market but exchange went on falling; on November 25th it fell to 1s. $3\frac{1}{8}$ d. British Postal Orders for £10,000 and other large sums were bought as a means of obtaining gold for remittance to London. Then realising the critical nature of the situation the Government of India, on the recommendation of the Secretary, of State began to give gold for export. The Secretary of State for India, being unable to sell Council Bills (there was no demand for them), released gold from the Paper Currency Reserve in London to meet his normal expenses; an equivalent amount of rupees was transferred at the same time in India from the Treasury Balances to the Paper Currency Reserve. This

action and the action of the Government of India improved the situation and raised the exchange to 1s. 3 $\frac{7}{8}$ d. on December 3, 1907. The Secretary of State also resolved that in case of a further fall in exchange, Sterling Bills were to be sold in India for rupees, encashable in London in sovereigns, at 1s. 3 $\frac{3}{4}$ d. per rupee. Such Bills are known as Reverse Bills. The exchange, however continued to be weak; the withdrawal of the Secretary of State did not improve matters at all. The Government of India, therefore, started selling these Bills at the above rate from the 4th March 1908 and kept on doing so till 11th September 1908. The Secretary of State also sold some of his securities belonging to the Gold Standard Reserve to keep himself ready with gold to pay the bills sold in India. On the 11th September 1908, the exchange recovered and the Government of India discontinued the sale of the Reverse Bills. In all £8,058,000 was withdrawn during this period from the Gold Standard Reserve, to pay the Reverse Bills. An additional sum of £933,749 was also borrowed from that Reserve to strengthen the balances of the India Office. During this period, *i.e.* from November 1, 1907 to 31 October, 1908, gold or gold assets to the extent of £ 18,000,000, in London and India combined, righted matters. Thus the amount of gold and gold assets in Paper Currency Reserve and Gold Standard Reserve in India and London was, on September 1, 1907, approximately £ 30,900,000. A year later, *i.e.* in September 1908, they dwindled to £11,150,000. It should be remembered that the Reverse Council Bills are always paid for by the Secretary of State for India from the gold and gold assets of the Paper Currency Reserve and Gold Standard Reserve in London.

We are to note one other point. The sale of Council Bills releases money from the Government Treasuries and cash balances and places it at the disposal of the Indian money market. The sales of the

Reverse Bills contract the currency to the extent of such sales. Thus during the crisis of 1907-08, the active rupee circulation, according to Mr. Keynes, was reduced by about £19,000,000: this was the amount by which, as noted already, the sterling resources were reduced.

From 1908 to 1914 India had a balance of trade very much in her favour, so much so that not only the stock of rupees which had accumulated in the Gold Standard Reserve during the crisis of 1918 was re-issued, but heavy coinage was undertaken in 1912-13 and 1913-14; the profit on this coinage swelled up the Gold Standard Reserve kept in London. very much beyond its former limit.

This crisis of 1907-8, the first of its kind, taught the following lessons:—(1) The necessity of strong reserves to meet a critical situation; (2) the advantages of holding the gold and the sterling reserves in London where they are required, and (3) the advisability of formulating in advance and of publicly announcing the policy to be followed in a crisis. The sudden fall of the exchange to 1s. 3 $\frac{3}{4}$ d. in Calcutta in November was due, not to any insufficiency in the sterling resources of the Government but to a temporary failure to utilize these reserves properly. Had the Government started giving gold from the beginning, the exchange would never have fallen so low.

CHAPTER VII

EXCHANGE STANDARD

We will trace in the subsequent pages the history of Indian currency down to the present day, and explain the shape it has ultimately taken. But that shape, the reader will find, differs very little from what it took by the year 1908. By that year the Indian currency took a definite, though un contemplated shape, a shape which it still retains in all its essentials.

The main features of this currency were as follows* :—

(1) The rupee, a token coin, was unlimited legal tender and legally inconvertible into gold.

(2) The sovereign was unlimited legal tender at Rs. 15 per £ and was convertible into rupees at 1s. 4d. per rupee : *i.e.* the Government undertook to give 15 rupees in exchange for one sovereign. In other words the gold price of the rupee or the exchange was fixed at 1s. 4d. It is worth noting, and it has been pointed out more than once, that this provision prevented the value of the rupee from rising above 1s. 4d. by more than the cost of remitting sovereigns to India.

(3) As a matter of administrative practice, the Government were willing to give sovereigns at the above rate, *i.e.* any one could get a sovereign in exchange for Rs. 15 : but this practice was sometimes suspended.

(4) The Government also undertook to sell in Calcutta, in return for rupees tendered there, bills payable in London in sterling, at a rate not more unfavourable

* Keynes, Currency and Finance, Chapter I.

than 1s. $3\frac{29}{32}d.$ per rupee, *i.e.* 1s. 4d. *minus* the cost of transmitting gold to London, which was generally $\frac{3}{32}d.$ per rupee. This provision was of great importance; and a failure to carry it out was likely to bring about a failure of the whole system, as it did in 1907-08.

Thus the upper limit was fixed at 1s. $4\frac{1}{8}d.$; the price of the rupee could not go beyond that limit as the Secretary of State was always willing to sell his Bills at 1s. $4\frac{1}{8}d.$ The lower limit, for similar reasons, was fixed at 1s. $3\frac{29}{32}d.$ The price of the rupee was, therefore, to vary between these two limits.

Thus the rupee remained, as it is now, the most important local currency. The Government, however, mostly for purposes of international payments, undertook to convert the local currency (*i.e.* the rupees) into the international currency (*i.e.* gold) at a fixed rate. This system of convertibility of gold into rupees (*i.e.* Council Bills) and of rupees into gold (*i.e.* the Reverse Bills) is the characteristic feature of this currency. For this purpose of convertibility two things were required, *viz.*

1. Sufficient rupees to enable the Government to convert international currency (*i.e.* gold which in India was generally represented by Council Bills, though it was often actually presented for conversion) into the local currency *i.e.* rupees, and

2. Sufficient Sterling resources for the conversion of the local currency, *i. e.* (rupees generally represented by the Reverse Bills sold in India) into international currency. For these two purposes the Government were to keep two reserves: one of gold and the other of silver.

Thus the actual medium of exchange was a local currency, distinct from the international currency, the Government was more ready to redeem the local currency (rupees) in bills payable in international currency in London, and to redeem bills in international currency into the local currency. This system of currency has been called the Gold Exchange Standard, and it is, as the reader must have found out by this time, similar to the scheme placed before the Fowler Committee by Mr. Lindsay, though it was then rejected by the Committee as being undesirable and impracticable. The main purpose of that scheme was to have rupee as the local currency and to make gold available mainly for international payments.

Thus the recommendations of the Herschell and Fowler Committees were not carried out. A gold standard of the nature described above was established without a gold currency. A country may be said to have the gold exchange standard, if in that country gold does not circulate freely, the local currency is not redeemable into gold, but the Government or a Central Bank makes arrangement for the remittance of gold to foreign countries at a fixed rate in terms of the local currency, the reserves necessary to provide these remittances being kept, abroad to a considerable extent.

Reserves.

We shall now discuss the nature, the functions and the number of these reserves on which depends the stability of the system we have just now outlined. The reserves are:—

1. *The Gold Standard Reserve.* It was created in 1900 and kept at first wholly in London in gold securities. From 1906 it was kept partly in gold in London and partly in India in coined rupees; it was created from the profits on the coinage of rupees. It was out of this

reserve that the Reverse Bills sold by the Indian Government in Calcutta during this crisis of 1907-8 was paid. The main function of this reserve is to prevent the exchange from falling below $1s. 3\frac{29}{32}d.$ per rupee. The Reverse Bills, or as they are sometimes called the Sterling Bills, were never sold at a rate below $1s. 3\frac{29}{32}d.$ When the balance of trade goes against India and consequently exchange falls and the Council Bills do not sell, these Sterling drafts are sold in India at the lower specie point, preventing the exchange from falling below it; they are sold in exchange for rupees and are payable in London in gold or sterling. They are paid for from this fund in London.

The Paper Currency Reserve. As the name implies its main function is to enable the Government to cash the currency notes, in case their holders so desire. It is kept partly in England and partly in India. If necessary, the Council Bills or gold are paid from this fund and an equivalent amount either in gold or in silver is transferred from the Gold Standard Reserve to this Currency Reserve. We shall discuss the nature and composition of the Currency reserve more fully when we shall deal with Paper Currency.

3. *Cash Balances.* These balances are kept partly in India and partly in England. The Indian balances are kept in the District Treasuries, branches and the head office of the Presidency Bank and the three Reserve Treasuries; now they are mostly kept in the Imperial Bank and its branches. These district treasuries do not keep more resources than they require to meet the current expenses of the Government. The London Balances are kept partly at the Bank of England and partly loaned out for short periods.

The names of these funds indicate their primary functions; but neither in practice nor in theory, in the

language of the Chamberlain Commission, have the separate portions of the fund entirely reserved for the objects indicated by their names. Some time a currency note is paid out from the cash balances, and a Council Bill from the Paper Currency Reserve; whenever this is done, an equivalent amount is transferred from the Paper Currency Reserve to the cash balances and from the Paper Currency Reserve to the Gold Standard Reserve.

Advantages

The Gold Exchange Standard, an outline of which we have given in the preceding pages, received enthusiastic support from many able economists such as Mr. J.M. Keynes, from whose *Indian Currency and Finance* we have quoted very often. We shall discuss the view-point of the Chamberlain Commission, appointed in 1914 to go into the whole question of Indian Currency, in a later Chapter. Here we will confine our attention only to certain general advantages, which the system we are dealing with, is supposed to possess.

1. It is often urged in support of this system that, though gold standard is the rule in all parts of the world, a gold currency is an exception. The idea of a 'sound currency' *i. e.* a gold standard with a gold currency, is based upon a misconception of the English Currency system. Though England was practically speaking the first country to adopt the gold standard with a gold currency, in course of time an extensive use of cheques slowly grew up, and the use of metallic money became secondary in importance. Even in pre-war days gold coins were used in Great Britain generally for three purposes :—

(1) Out-of-pocket expenditure such as railway travelling, (2) for the payment of wages and (3) whenever a drain of specie abroad took place. For every other object the British people used the cheque. In other countries, in pre-war days, gold did not form the principal currency because it had been found that the expense of a gold cir-

ulation was very heavy and that large economies could be effected by the use of cheaper substitutes. It is said that Egypt was the only country in which gold coins were used extensively as the principal form of currency.

2. Their second argument is that a gold currency is of no avail in setting right an adverse balance of trade. After examining the methods adopted in pre-war days by various European countries to meet an adverse balance of trade, Mr. Keynes says that they never did so with the currency in circulation. England, being a creditor country in the short loan market, met an adverse balance of trade by regulating the Bank rate. When the balance of trade turned against her and gold tended to flow out, the rate of discount was raised by the Bank of England; as soon as the rate was increased, the brokers who lent out money on short terms to foreigners, contracted their business and thus stopped the flow of gold. But this method was successful in England because England was a lender country: The position of other countries was somewhat different. They were mostly debtor countries. They depended generally on the resources of their Central Banks; sometimes they suspended the payment of gold. These banks did not hold much gold in reserve as the expense of such a method was 'intolerable'. They entered into the international money market, bought foreign bills which they sold off in times of necessity. The system, it has been argued, is closely akin to the gold-exchange standard. The Gold Standard Reserve which invests its money in securities plays the part of the Central Banks.

3. Thirdly this system has enabled the Government of India to earn a huge sum because of its cheapness. The whole of the Gold Standard Reserve is composed of the profits on the coinage of rupees. This argument is perhaps the strongest argument in favour of the exchange standard.

4. This system was supposed to be a very natural one as it led automatically, in times of prosperity to an *expansion* of the currency and, in times of depression to a *contraction*. In times of activity when business prospered and trade expanded, the country required generally more money. In such times exports increased, resulting in a demand on the part of the foreign merchants for Council Bills which were encashed in India, releasing money from the Reserves and balances and placing it at the disposal of the people. If the demand for Council Bills was unusually high, new rupees were coined to enable the holders of these bills to cash them and pay their creditors in India. The same results would take place, even if Council Bills were not sold. Gold would be exported to India, cashed in Indian treasuries and would thus release rupees and notes. Similarly when a crop failed and exports fell, or when a world crisis came, foreign merchants contracted their purchase of Indian articles; the country then did not require more money than usual. The demand for Council Bills on such occasions fell and sometimes stopped, hence little or no money was released from the reserves and the balances. In case of an adverse balance of trade, Reverse Bills were sold and the rupees with which they were bought flowed into treasuries and the reserves, and thus the currency was contracted. This automatic expansion and contraction of the currency was supposed to be the greatest merit of the pre-war Indian exchange system. Later on, in 1925, it was, however, pointed out by the Hilton Young Commission that the greatest defect of the pre-war Indian currency system was the absence of this quality. In the opinion of Sir E. Hilton Young and his colleagues the Indian currency was never expanded to the full amount of the sales of Council Bills, nor contracted to the full extent of the Reverse Council Bills sold. Further under the pre-war system, the

currency was expanded, not in response to the expansion of trade *as a whole* but only in response to the demand of *external trade only*. During a period of favourable balance of trade, the number of Council Bills to be sold was appreciably increased, and the amount of currency released swelled up the active currency, out of all proportion to the expansion of the total trade, external and internal. No body ever took notice of the internal trade which was much larger than the external trade.

These arguments no doubt hold good in ordinary times; and it was no fault of its admirers if they failed to see that circumstances might arise, as they did in 1921-22, which would break the whole system and suspend all its activities. Not only that; in a reckless attempt, born of over-confidence in the efficacy of this system to meet an adverse balance of trade, the Indian authorities lost as much as 35 crores of rupees in the course of 6 months. That is sad tale which not only casts reflection on the financial wisdom of the Indian authorities but arouses legitimate suspicion in the minds of sober men as to the efficacy of the system.

CHAPTER VIII

CHAMBERLAIN COMMISSION, 1914.

SCOPE OF ENQUIRY

The third committee appointed in 1914 to enquire into the working of the Indian Currency System was a Royal Commission and was appointed by His Majesty the King Emperor of India. Sir Joseph Chamberlain, who afterwards became the Chancellor of the Exchequer of the British Cabinet, was appointed the Chairman and, for the first time, an Indian, a Parsi merchant, Sir S. B. Broacha, Kt. was appointed one of the members. The Commission was appointed to enquire into :—the location and management of the general balances of the Government of India, the sale in London of Council Bills and Transfers, the measures taken by the Government of India and the Secretary of State for India in Council to maintain the exchange value of the rupee, the location, disposition and the employment of the Gold Standard and the Paper Currency Reserves, and whether the existing practice in these matters was conducive to the interest of India and also to make recommendations on them. The Commission submitted their report in February, 1914.

Gold Currency

No free coinage of silver. The Commission, after taking a rapid view of the situation, which we discussed in the last chapter, of the currency system as it developed from time to time from 1900 to 1913, discussed the advisability of introducing gold currency into India. The question whether the Indian mints

should be reopened to the unrestricted coinage of silver was no longer a controversial one. The stabilisation of the rupee had enabled the Government of India to remit much of the taxation which they had to levy on account of the difficulties arising from an unstable exchange. From this fact the Commission concluded that India had derived substantial benefit from the substitution of gold for silver as the standard of value. The Commission noticed that the system of currency obtaining in 1914 differed materially from the one recommended by the Fowler Committee. The investment of the Gold Standard Reserve in London in securities, the dropping of the scheme for a gold mint in India, the practice of selling Council Bills below the gold points, and the establishment of the silver branch of the Gold Standard Reserve in India were the points in which the Indian currency differed from the scheme of the Fowler Committee. Instead of a gold standard with a gold currency India adopted the exchange standard, very similar to the scheme submitted to the Fowler Committee by Mr. Lindsay. The Commission also observed that the standard had been maintained with great success from 1899 to 1914; only once, *i. e.* in 1907-08 it was severely tested and the price of the rupee fell below

1s. $3\frac{29}{32}$ d. This failure to maintain the rupee between

the gold points, was attributed by the Commission to a failure to understand the scheme. Both the Secretary of State and the Government of India should have promptly allowed the sale of the Reverse Council Bills.

The Commissioners found that during the 12 years ending the 31st. March, 1913, India had imported, apart from gold bullion, sovereigns to the extent of £ 60,000, 000. Though it was difficult to ascertain with any accuracy how many of these sovereigns passed into active circulation, the Commissioners believed that a large

part of them were never put into circulation; certain parts of the country, such as parts of the Bombay Presidency and of the United Provinces, the Punjab and Cochin, however, made an increased use of them. The policy of the Government was also to popularise the use of gold as much as possible; whenever the public wanted gold, they got it. But in spite of this, the use of sovereigns as the medium of exchange was almost negligible. In many parts of the country people had shown a distinct preference for rupees. Was it desirable under the circumstances, the Commission asked, to have a gold currency in India?

The Commissioners then proceeded to discuss the arguments in favour of an active gold currency. The arguments in favour of a Gold Currency were summed up by the Commission as follows:—

1. That gold was a more convenient and portable form of medium of circulation than the rupee. In the opinion of the Commissioners this argument was valid only in the case of large payments which could not be made with notes; for many years to come however such payments must be made in India in rupees and gold could not take their place. If there was little chance for the people to use gold in the place of rupees, why did not the Commission make the rupee freely convertible into gold! The refusal of the Government to convert the rupees into gold raises a legitimate presumption that the Government feared that gold might be used as extensively as the rupee. Further we should note that what the advocates of a gold currency wanted was the convertibility of the rupees into gold; they did not want to dislodge the rupee from its position. In England cheques were as freely used as the rupee in India; gold was used, as noted already, on rare occasions; still all the cheques were legally convertible into gold. A similar arrange-

ment was wanted in India. Again if the rupees were used only in small transactions, why were they made unlimited legal tender ?

2. That a gold currency was a necessary step towards an ideal currency, *viz.*, paper backed by gold in reserve. The Commissioners in reply to this argument, said that this theory had no historical evidence to support it. A study of the history of the currency system of the world did not lend support to the theory that paper currency could only be reached after a gold currency had been in circulation. The argument may be correct ; but if the people were to have confidence in the currency system, the best method would have been a gold standard with a gold currency. Such a system would have inspired the confidence of the people, shaken off their hoarding habits and ultimately led to the establishment of "an ideal currency." Unless the people were assured that they would get back their gold, they would never hand it to the Government. They have not done it till now.

3. That some prestige attached to the possession of a gold currency, whereas a silver currency was the mark of less progressive peoples. This argument, in the opinion of the Commission, was based on a confusion between a gold standard and a gold currency. For internal purposes a cheap currency, say cheque, was the most progressive and the best system ; not one of the great powers of Europe had a large amount of gold in actual circulation.

4. That the large amount of gold in circulation was a strong and, in the view of some people, the only adequate support for exchange. This argument, though apparently strong, was invalid, thought the Commissioners. It was argued that if gold had been used in India as much as in England or Germany, the exchange problem would have been very much simplified. Not

so, opined the Commissioners. Neither England nor Germany depended, for stabilising their exchange, on their gold currency; they depended, as we saw in Chapter VI, on their bank rate and on the reserves in Central Banks; they never supported a falling exchange by withdrawal of the gold in circulation. The English system was a peculiar system; England's position as a lender country in the international money market and the organisation of the London money market were the only means of stabilising the exchange. In the second place if gold was to be used as extensively as in Egypt, then no doubt gold from circulation would be available for export in considerable quantities at times of depression; but if so much gold was to be put into circulation, it would be necessary to reduce the note-issue and to withdraw, at a considerable expense, a large part of the rupees in circulation. If, however, gold was to be put into circulation without any detriment to the circulation of notes and rupees, gold would occupy only a subsidiary position for many years and would be of no avail in meeting an adverse balance of trade. Experience showed that as long as the public had the option of making payment in tokens or in gold, they always had used the former; and people would continue to do so until the tokens had been so much contracted that any further use of them would inconvenience the ordinary internal transactions. In support of this view the Commissioners cited the case of 1907-08; in that year as much as £ 4,179,000 of gold was withdrawn from the paper currency by the public, though only £ 250,000 was exported on private account. In the third place if the sovereigns were to take the place of the new rupees, the Gold Standard Reserve, which had grown out of the profits on the coinage of rupees, would cease to grow (except in so far as its funds might be invested and earn interest). Such a

procedure would fail to strengthen a weak exchange: neither much gold could be obtained from circulation, nor the Gold Standard Reserve would be sufficient, in case of a serious weakness, to strengthen the exchange.

5. That the constant mintage of fresh rupees was objectionable and should be avoided by an increasing supply of sovereigns. Apart from what has been said in reply to point 4, the Commissioners feared that a large supply of gold, instead of taking the place of the rupees, might oust the notes, a result which even the advocates of a gold currency would not favour. India, being a poor country, would always require rupees for many petty internal transactions; a gold coin would naturally be of a much higher value than the rupee and would not be required in those petty transactions which could only be carried on most conveniently with rupees. The Commissioners said in this connection. "It is remarkable how uniformly in districts where the use of gold is considerable, the use of notes is below the average."

6. That until India had a gold currency in active circulation, India would continue to possess an artificial and managed currency. In the opinion of the Commissioners this criticism was based upon a confusion between the Indian system and the British, according to which gold coins could be minted by anyone. The Commissioners thought that there was not much difference between the British system and the Indian system according to which though gold could not be minted freely, any amount of sovereigns might be imported into the country and used as currency. The Commission admitted that the Indian system was managed in the sense that the rupee, a token coin with a face value much above its intrinsic value was unlimit-

ed legal tender. But for that reason alone the Commissioners were unwilling to accept the view that the system was a bad one.

Mint for coining gold. As regards the proposal for opening the mints to the coinage of gold, the Commissioners held that such a proposal, in view of the opinions expressed with regard to gold currency, should not be accepted. Without the mint gold had freely flowed into India, and the Commission doubted whether the opening of the mint would afford better attractions for the gold to flow in. A mint was also not necessary for winning the confidence of the public in the stability of the exchange. The exchange had been maintained at the statutory ratio, inspite of the occurrences of 1907-8, and people did not require any mint to prove the determination of the Government to do so in future. The argument that an open mint would add to the sovereigns in circulation, a process which was itself undesirable, was untenable in view of the fact that without the mint gold could be obtained as much as the people liked under the circumstances then existing. The Commission, however, recommended that the Mint at Bombay should receive refined gold in exchange for rupees or notes; if that was done, the hoards might be easily converted, in times of distress, into rupees and notes, and the necessity of a mint would not be felt at all.

Conclusion. Thus the Committee concluded that gold in circulation being wasteful, it should not be introduced as the currency of the country; that the Indians should be encouraged to develop economical habits in matters of currency; and though cheques or notes were more economical than the rupees, the latter were to remain, owing to the ignorance and illiteracy of the people, for long years to come the principal currency of the country. But the Commission held that if Indian

sentiment would genuinely demand gold, and the Government were prepared to incur the expenses, there was no objection on principle to such a currency, provided such gold coins were British sovereigns and half-sovereigns. The Commission held that in their opinion "India neither demands nor requires gold coins to any considerable extent for the purpose of circulation (as opposed to hoarding), that the most suitable media of internal circulation in India at present are rupees and notes, and that the Government should, as opportunity may offer, encourage notes, while providing, and this is the cardinal feature of the scheme—absolute security for the convertibility into sterling of so much of the internal currency as may be required at any time for the settlement of India's external obligation." The Commission also pointed out that the Government should give that currency which the people wanted. The Government should not refuse to give gold, if the people required it; but they should try to discourage the use of gold as currency.

The Gold Standard Reserve

Number of Reserves. The question which the Commission next took up for discussion was the function, composition and location of the Gold Standard Reserve. To maintain the price of the rupee India required sterling resources. These resources are, we should remember, crux of the whole system. They were the Gold Standard Reserve, the gold of the Paper Currency Reserve held in London and the cash balances of the Secretary of State.

Functions. As regards the function of the Gold Standard Reserve the Commission held that the Reserve was not only to meet the Home charges at a time when, owing to an adverse balance of trade, the Council Bills could not be sold but also to maintain the exchange in case it fell below the statutory

limit, just as was done in 1907-08. On the other hand the Commission held that the Reserve was not to be used for converting the rupees in circulation into sovereigns; gold was international money and should be kept apart for international payments only.

Amount. The next question which the Commission took up was the amount which was to be kept in the Reserve. The demand on the Reserve depended on the nature and extent of an adverse balance of trade which might overtake India in future as it did in 1907-8. The trade of India had expanded during the last few years, and it was likely to expand more in future. The balance of trade was very favourable for India; but the more favourable the balance of trade for India, the greater would be the the extent of an adverse balance. Keeping this view in mind the Commissioners were unable to accept £18,000,000, the amount required in 1907-8, as the maximum amount that might be required from the Reserve. Had the year 1907-8 been followed by a second failure of the monsoon in 1908-9, the situation would have been much worse, and a much larger amount would have been required to strengthen the exchange. Another point which the Commission pointed out in this connection was that if the storm centre had been London (in that year it was New York), the Secretary of State for India would have found it very difficult to sell his securities in which the Reserve was then held and pay the Reverse Bills. In view of these considerations the Commissioners were unable to fix any limit up to which the Reserve was to grow and held that for some years to come the entire profit on the coinage of rupees should be credited to the Reserve.

Location. As regards the location of the Fund the Commission held that London was the most suitable place. London was the place where money was required for the Secretary of State as well as for the

payment of India's obligation to the foreign countries. If the Reserve was to be kept in India, it should have to be shipped to London in case of necessity; such shipping should invite delay in making the gold available in London. The Commission, therefore, recommended that the whole of the Reserve should be kept in London. The Commission repudiated the suggestion that the object of keeping the gold in London was to supplement the reserve of the Bank of England.

Composition. With regard to the composition of the Reserve, the Commission pointed out the danger of investing the fund in securities, which at the time of a crisis might not fetch the amount for which they might have been bought. The realisation of securities in a large quantity and the calling in of sums, lent out at short notice, in a crisis, might cause some stringency in the London money market; and if the exchange crisis in India was due to some financial crisis in London, the difficulty of selling the securities and realising money would be greatly enhanced, and India was likely to lose heavily as such securities might fetch much less than they were bought for. With these possibilities before them the Commissioners held that not less than one half of the Fund should be held in actual gold as soon as the total would exceed £30,000,000; and that a minimum amount of £15,000,000 should be accumulated immediately; the rest should be kept in liquid assets. The Commission observed that gold in the Gold Standard Reserve was always very insufficient. In 1913 there was no gold in the Reserve.* The Commissioners also advised that whenever circumstances (*i. e.* an adverse balance) would compel the Secretary of State to have recourse to the Gold Standard Reserve, he should do well to use both gold and securities; but gold should be released to facilitate the realization

* See Chapter VII.

of the securities.

The Commissioners recommended the abolition of the Silver Branch of the Gold Standard Reserve in India, which was created in 1906 by exchanging 6 crores of rupees, the total amount of the branch, for £4,000,000 from the Paper Currency and shipping that gold, whenever convenient, to London which was the most convenient and suitable place for the Reserve.

The Commissioners also advised the Government to announce by a public notification their intention to sell sterling bills (Reverse Bills) in India at 1s. $3\frac{29}{32}$ d., whenever they would be asked to do so. Such an announcement would inspire, thought the Commissioners, confidence in the minds of the people, reduce the actual demand for drafts on London and prevent that feeling of panic which was caused in times of trade depression.

Cash Balance

Both the Government of India and the Secretary of State always keep balances mainly for the purpose of meeting their expenses. The minimum working balances for the Secretary of State, the Commissioners were told, normally amounted to about £ 4,000,000, and those for the Government of India were about £ 8,000,000. These estimates were based on experience and the Commissioners had no reason to dispute them. The balances stood thus :—

31st March	In London in £	In India	Total
1908	4,607,266.	12,851,413.	17,458,679.
1912	18,390,013.	12,279,689.	30,669,702.
1913	8,783,970.	19,293,131.	28,077,101.

There were great excesses, as these figures show, over the amounts required. The Commissioners attri-

buted these excesses to two causes. First, for several years past there had been either an improvement in the revenue or a falling off in the expenditure, a result which could not be anticipated at the time the budgets were framed. The Government of India, in this respect followed a very cautious policy, a policy which, in the opinion of the Commissioners, was justified by the fact that in a country like India, which had years of prosperity followed by years of adversity, it was unsafe to spend the whole of the balance in a year of prosperity and invite troubles in a year of trade depression. Secondly, the Government of India did not spend the whole amount estimated on capital account and thus had saved much.

The existence of such large excesses had led many to ask for a reduction of taxes, a proposal which the Commissioners were unable to accept, particularly in view of the fact that the revenue from opium was likely to decrease considerably in the near future and that new expenditure was likely to be incurred on education and sanitation. It was pointed out to the Commission in connection with heavy cash balances of the Secretary of State that money had been unnecessarily removed from India and placed at the disposal of the London money market.

India Balances The balances of the Government of India were kept in the various district treasuries and sub-treasuries, the branches of the Presidency Banks, the head offices of those banks at Calcutta, Bombay and Madras and the Reserve treasuries at these three places. The balances kept at the district treasuries and sub-treasuries and at the branches of the Presidency Banks generally did not (they do not exist now) exceed the immediate requirements of the Government. The balances at the head offices of the Presidency Banks, were not generally allowed to exceed

a certain fixed maximum. Thus whatever balances the Government had at any time, tended to accumulate in the Reserve Treasuries. This Independent Treasury system was not an ideal one, as the money locked there was not loaned out to the Indian market and laid idle. The Commissioners thought that, inspite of certain objections, this money should be lent out to the market as such lending had several distinct advantages; *viz.*, it would earn a little interest, help the Government in raising their rupee loan and finance the Indian traders in moving their crops in the busy season of the year. The Commissioners proposed either the abolition of the Independent Treasury system and placing the whole of the balance with the head offices of the Presidency Banks or the introduction of the practice of lending out from their balances. The loans were to be given only to the Presidency Banks, the Government could give such loans at any time they liked, and the amount of the loans should be determined by the Government. The Government, however, were to proceed very cautiously.

India Office Balances. The India Office balance is required to meet the expenditure of the Secretary of State for India. His income amounted (in 1914) to £20,000,000 a year on an average for revenue expenditure and £9,000,000 for capital expenditure. This balance came mainly from two sources, from the proceeds of the sale of Council Bills and from loans raised in London. The normal balance required on the 31st March in each year amounted to £4,000,000, more than half of which was needed in April every year. At the time of framing the annual budget the Government of India make an estimate of the amount of Council Drafts that they would be able to meet throughout the year. The India Office, on the basis of this estimate

frames a ways and means budget for the Home charges and arranges to borrow the amount required to balance its account. As the Council Bills were sold mostly in the Indian busy season, the greater part of the money from India came towards the end of the financial year. As money could be borrowed easily from the London money market in the beginning of the calendar year, the Secretary of State borrowed the amount either in the first half of the financial year or in February or March in advance of the financial year. Under such conditions the Commissioners held that it was impossible for the Secretary of State to regulate his borrowing for the needs of the year in accordance with the surplus or deficit over the estimate of his receipts from Council Bills. One of the ways to obviate this difficulty was to change the financial year from April to January.

Under an old-standing arrangement the India Office maintained a minimum balance of £ 500,000 with the Bank of England; a very small amount of cash was kept with the Accountant-General for daily use and the rest was placed on temporary loan in the City of London. These loans were usually given to "Approved Borrowers," a list of whom was kept at the India Office. Such borrowers had to deposit at the Bank of England, securities of a specified kind against the loans made to them. The Commission approved of this system as, in their opinion, it had worked satisfactorily.

It was pointed out to the Commission that the excess ought to have been kept in India to help the Indian market. The Commission held that such excess should be ultimately used for liquidating debts; and for that purpose London was the best place. They admitted that in the interim period, it should be lent out against the best security and at the highest rate of interest obtainable. The Commission, however,

did not trouble themselves with the task of finding out whether the Indian market in that respect would be better than London market. The half-hearted way in which the Commission dealt with the question is very unconvincing. It was clear that they did not like the idea of depriving the London money market of the help it received from Indian money at the expense of India.

Council Bills

We have already discussed the nature and function of these bills. We intend to confine our attention only to the views and recommendations of the Commission on this subject. Since 1900, as noted already, the sale of council bills had assumed new importance; they were sold not only to meet the immediate requirements of the Secretary of State but for transferring the sovereigns that had accumulated in the Paper Currency Reserve in India and for remitting to London the profit on the coinage of rupees. Thus in 1909 and 1910, when the crisis of 1907-08 was over, Council Drafts were sold freely in London to transfer the large amount of gold which had accumulated in the Gold Standard Reserves in India through the sale of sterling bills in India. It was suggested to the Commission that the Council Bills should be sold so long as there was a demand for them, and that such bills should be sold only to meet the Home charges. The Commission, however, were opposed to both the views and held that the extent of the sale of Council Bills depended on the requirements of the Government both immediate and prospective; on the one hand, the interests of trade were in themselves no justification for the sale of Council Bills in excess of his requirements; on the other hand the attempt to restrict the sale was arbitrary. This argument does not seem to be very illuminating; to say the least, it is vague and unconvincing.

The Commissioners held that the practice of selling Council Bills on every Wednesday at a price not below 1s. $3\frac{2}{3}d.$, then in vogue, was, when the India Office balances were high, unjustifiable. It was pointed out, in support of this practice, that in this way the India Office was able to feel the pulse of the market and take advantage of an increase in demand. The Commission held that this could be done in a much better way by inviting tenders weekly while refusing to sell at very low rates except when money was actually required. The Commissioners were also unable to accept the view that Council Drafts were to be sold at a fixed price, say 1s. $4\frac{1}{16}d.$ or that they should never be sold below par, *i. e.* 1s. 4d. With regard to 1s. $4\frac{1}{16}d.$ the Commissioners held that it might not be always possible to sell the drafts at such a high price; and, though to sell them at par might be desirable, the Commissioners thought that such restriction might impose additional responsibilities on the Government of India, for which there was no adequate justification. The Council Drafts were to be sold, in the opinion of the Commissioners, so long as funds were to be remitted to London from the cash balances, Paper Currency Reserve and the Gold Standard Reserve in India. The Commissioners approved of the general policy followed in respect of the sale of the Council Bills. That policy was to regulate the time and amount of the sales of the Council Draft throughout the year, according to requirements, so as to take full advantage of the demand for such drafts in order to lay down funds in London. The primary and by far the most important function of the Council Drafts, the Commissioners pointed out in summing up their views on this subject, was to transfer public funds from India to London for the require-

ments of the Secretary of State. This was also true not only of those Council Bills which were met from the Treasury Balances in India but also of those which were met from the Reserves in India, since the object of these sales was to transfer to London such portions of the two reserves as were required either permanently as in the case of the Gold Standard Reserve or the gold portion of the Paper Currency Reserve or temporarily as in the case of moneys belonging to the Paper Currency Reserve, which were required to purchase silver for coinage.

This view was not supported by the Babington Smith Committee, appointed in 1919, to go into the matters. According to them the sale of these bills, was primarily intended to provide funds in England and to meet the expenditure of the Government of India in London; it was also found convenient to extend the sales so as to provide additional currency to meet the requirements of trade.* These Council Bills with the precious metals played an important part, as is shown in the table below, in adjusting India's Trade Balances:—†

	Excess of Exports over Imports on private account.	Net Imports of Treasures (gold & silver) on private account.	Net Sales of Council Drafts (<i>i.e.</i> Council drafts less Reverse drafts.)
	£	£	£
1904—5	40,548,200	16,700,600	24,150,000
1905--6	39,086,700	9,646,900	31,886,000
1906—7	45,506,600	14,420,000	34,069,400
1907—8	31,640,000	18,253,300	15,676,700
1908—9	21,173,300	11,110,300	5,335,300
TOTAL ...	177,954,800	70,137,100	111,117,400

*Report of the Babington Smith Committee, para. 7.

†Same, para. 8.

	Excess of Exports over Imports on private account.	Net Imports of Treasures (gold & silver) on private account.	Net Sales of Council Drafts (i. e. Council drafts less Re- verse drafts).
	£	£	£
1909—10	47,213,000	20,688,000	27,710,600
1910—11	53,685,300	21,700,000	26,389,800
1911—12	59,512,900	28,706,000	26,917,500
1912—13	57,020,900	29,435,000	25,983,500
1913—14	43,753,900	19,713,000	31,200,800
Total	261,186,000	120,242,000	138,202,200

Note by Sir James Begbie

Sir James Begbie, one of the Commissioners, was unable to accept the gold exchange standard. He strongly held the view that an exchange standard would not serve the best interests of the country. In an exchange standard, he pointed out, the stability of the external value of the rupee depended entirely on the strength of the reserves. But such a standard, though successful in the past, had brought into existence an expensive token currency (*i. e.* the rupees) which, in his opinion, was not conducive to the interests of India. He held that for a country which absorbed gold so extensively as India, a token currency of such a large amount was very undesirable.

In the first place, he pointed out that the argument that the people preferred and demanded rupees had lost much of its force. During the last 11 years the people had absorbed equal amount of rupees and sovereigns, and during the last four years their demand for

sovereigns had largely increased. These facts showed that there had been important changes in the currency needs of the people and indicated a preference for gold over rupees.

In the second place, he held that the analogy between the Indian system and the systems obtaining in other countries was not based on sound logic. True, in some countries such a system had been adopted, but conditions of these countries were not identical with those of India. In none of them, Sir James pointed out, there had been the same absorption of gold as in India. The recent demand for gold showed that the people had lost confidence in the token rupee and had distinctly preferred gold to rupees. There was no justification for the Government, in these circumstances, to expand a token currency in which the people had lost their confidence.

The third argument of the majority in support of the exchange standard was that it was desirable to educate the people in the use of more economical forms of currency than gold. Sir John admitted the soundness of this argument. He agreed that the increased circulation of notes in India was no doubt an advance towards the use of economical forms of currency. But this increased use of notes, in his opinion, was not due to any desire on the part of the people to economize in currency but to the facilities arising out of the use of notes. He laid special emphasis on the increased demand for gold which in his opinion dominated the whole currency system of India. For a country which took gold in great quantities, an extensive token currency was most unsuitable. It had, the usual effect of drawing gold out of circulation. It had still the greater disadvantage that it kept the gold out of useful employment. People who valued gold so highly as to

store and hold it to the extent witnessed in India, were not likely to invest or make other profitable use of it, so long as they were to take the risk of being repaid in token coins when they would realize their investments. What was wanted was not education in the economical use of currency but education in the use of the stored-up gold. The first step, to effect this, would be to convince the people that if they would use their gold, they would get it back whenever they wanted it; and this could not be done as long as there would exist an extensive token currency. "Gold coins would be used for many ordinary currency purposes, and by using them the public would be gradually led to use gold for other purposes, such as investments, especially if a considerable circulation of gold existed, sufficient to inspire the public with confidence that when the gold is restored, they could get it."*

We endorse the views of Sir James. The extensive use of notes was not due to any confidence in the currency system but, as Sir James pointed out, to the facilities of handling notes. This view was borne out later during the war period by the heavy demand for rupees in exchange for notes which went to discount in many places. The hoarding of gold and people's refusal to invest it were due to the fact that the people believed that they would get notes in exchange for their gold. If they were assured that they would get back their gold, they would bring it out from the hoards and invest it. It was their fear to lose their gold and get token coins in exchange, which was wholly responsible for their hoarding habit.

Gold currency. The main argument against gold

* See Note of Dissent by Sir James Begbie, para. 6.

currency was that gold in the reserves was better than gold in circulation for the support of exchange. Sir James admitted that it was so but held that gold in circulation was a better protection for exchange than token coins.

In his opinion gold in circulation could never endanger exchange. "Moreover it is the surplus token and not the gold which will seek an outlet at times of weak exchange." Further, reserves of gold could be accumulated from a gold circulation through the note-issue and a good banking organisation. Even under the circumstances that existed then, Sir James held, the most satisfactory part of the gold reserves was the gold in the Paper Currency Reserve. With a free circulation of gold, a much smaller portion could be held in rupees and a correspondingly larger part in gold.

The argument that gold would be an expensive form of currency did not hold good in the case of India. Token Currency was steadily exchanged for gold and to that extent, Sir James argued, token currency was as expensive as gold currency. Further he observed that the large absorption of gold was due to the existence of a large token currency; a gold currency, in his opinion, would induce the people to take out gold from the hoards and employ it in a useful way. If a gold currency could do this—in his opinion it would do it—the expense of such a currency would be offset by stopping a huge waste. He also could not accept the view that gold coins would replace notes. Notes, he thought, would always be preferred for certain purposes.

The statement of the majority that "the hoarding habit is sanctioned by the experience of centuries in India and by religious and racial laws", in his opinion was wrong. This hoarding habit in his opinion was the

outcome of the policy which had brought into existence an extensive token currency. It was not a very old habit, nor was it sanctioned by any religious or social custom.

For these reasons he held that the proper line on which the currency system was to be based would be to discourage any extension of token currency and to provide for increased facilities for the distribution of gold when further increase in the currency would be necessary. He advised the minting of gold coins of a value which might be suitable for the general currency use and for the purpose of assisting the distribution of gold whenever more currency would be required to pay for the Council Bills.

CHAPTER IX

THE WAR 1914-1919

Position at the outbreak of the War

Before any active step could be taken to carry out the recommendations of the Chamberlain Commission, the Great War broke out, bringing with it consequences, both political and economical, the magnitude of which could not be anticipated by any kind of human intelligence and foresight. The present depression (1930-1932) through which the world is passing, whether due to the dumping of silver abroad by the Indian Government, or over-production, or the failure of the gold standard to work properly, is one of these consequences; it is due to some mal-adjustment brought about by the last Great War.

The currency system stood thus in 1914. Rupee, sovereign and half-sovereign were unlimited legal tender, the sovereign and half-sovereign being convertible into rupees at 15 Rs and Rs 7½ respectively (one rupee being equivalent to 1s.4d. as decided in 1898); currency notes of the denominations of Rs. 5 and upwards were unlimited legal tender and redeemable into rupees on presentation at the currency offices. Though gold coins had not been minted in India, the Government ordinarily issued them in exchange for rupees. The absorption of gold coins continued on a large scale. The Council Drafts were sold regularly, as there was a steady balance of trade in favour of India. The Secretary of State had a standing order for selling the Drafts without limit at 1s.4½d. per rupee; he also kept to the practice of not selling his Drafts below 1s. 3²⁹/₃₂d. per rupee as suggested by

the Chamberlain Commission. The Reverse Bills were to be sold also at the same price in case of an adverse balance of India. Owing to the favourable balance of trade the exchange was kept at the statutory value *i.e.* Rs. 15 per £.

Temporary effects of the outbreak of the War, 1914-16.

The outbreak of the war caused a temporary disturbance in the financial position of India; it soon passed off however. And as the war went on, a new difficulty, which threatened to be very serious, arose from a dearth of silver and its high price which dislocated the whole system and, in the opinion of many, broke down the currency policy of India.

As soon as the war broke out, the exchange became weak, *i.e.* fell low, and Reverse Bills to the extent of £8,707,000 had to be sold between the 6th. August, 1914 (the war broke out on 4th. August, 1914) and the 28th. January, 1915. Exchange also became weak in 1915-16 and between November 1918 and April 1919; Reverse Bills had to be sold during these periods again to strengthen the exchange, *i.e.* to raise it. The amount of Reverse Council Bills sold during these two periods was £4,893,000 in 1915-16 and £5,465,000 in 1918-19. For the rest of the period, however, the exchange remained strong.

Another effect of the outbreak of the war was the withdrawal of Savings Bank Deposits and encashment of notes; this was due to the belief that the Government might be defeated and people might lose their deposits and their notes might become mere scraps of paper. The net withdrawals from the Savings Bank Deposits in the year 1914-15 amounted to 8 crores of rupees. But this run lasted for a short time; the deposit thereafter continued to increase with the

result that it stood at $18\frac{3}{4}$ crores of rupees at the end of 1918-19 against 24½ crores in July 1914. There was also encashment of notes to the extent of 10 crores of rupees between 31st. July, 1914 and 31st. March, 1915. But from the spring of 1915 onwards the situation changed and the note-circulation increased steadily. On 3rd. November, 1919, the net circulation amounted to Rs. 178·93 crores against Rs. 66·28 crores in March 1915. There was also a keen demand for gold and the Government, unable to stop it, suspended the issue of gold to private persons. Between the 1st. and 4th. of August 1914, the Government had to pay £1,800,000 of gold in exchange for notes.

All these effects, as stated already, lasted for a short time. No doubt they caused a little dislocation of business and, for a time, disturbed the working of the currency policy of the Government of India; but soon the disturbing causes, brought about by a loss of confidence in the stability of the Government and their currency policy, disappeared, and the system began to work as smoothly as before. It should be noticed that this return of confidence was partly the result of the assurance that the Government gave to the banks and commercial communities of adequate and continuous facilities for remittance and their readiness to encash notes on demand.

Effect on the price of silver, 1916-19.

But the most serious effect of the war came to be felt from the end of 1916. From that year onward the price of silver began to rise rapidly; and it became increasingly difficult to supply it to meet the heavy demand for silver coinage in India. This high price of silver coupled with its dearth, made it extremely diffi-

cult to work the currency system and maintained the exchange at the statutory rate. We trace below the cause of this abnormal rise.

The balance of trade which since 1900 was in India's favour, turned heavily in her favour in 1916-17, 1917-18 and 1918-19 as will be clear from the table below:—

Year	Exports £	Imports £	Net Exports £
1914-15	121,061,100.	91,952,600.	29,108,500
1915-16	131,586,800.	87,500,200.	44,026,600
1916-17	160,591,200.	99,748,000.	60,843,200
1917-18	161,700,000.	100,280,000.	61,420,000
1918-19	169,230,000.	112,690,000.	56,540,000

The reason of this excess of exports over imports were mainly two. First, India could not import much from foreign countries as those countries were absorbed in producing articles for the immediate need of the battlefield and had little left for export. Secondly exports from India increased appreciably as they were in great demand in the belligerent countries which required more raw materials and foodstuffs than before, not only for home consumption but also for carrying on the war.

Owing to this large balance in India's favour there was a great demand for Council Bills to pay for the excess of exports. Consequently there was a heavy demand for rupees to pay the Bills, which resulted in the rise of the exchange. But this fact did not stand alone; other causes complicated the situation, intensified this demand for silver and raised its price.

During the war India formed the base of the military operations in Mesopotamia, Persia and East Africa. The Government of India had to pay the British and Indian soldiers and meet the Civil expenditure of

the occupied territories and had thus to incur a very heavy expenditure which amounted, from 1914 to 1919, to £240,000,000. (This amount was, however, recoverable). These exceptional disbursements created a heavy additional demand for Indian currency.

There was also a decline, often very heavy, in the imports of precious metals, a decline which worsened a situation which was already very serious.

Table showing the imports of the precious metals (gold and silver, coin and bullion).

Years	Total imports	Year	Total imports
1909—10	20,688,000	1914—15	12,313,000
1910—11	21,700,000	1915—16	6,984,000
1911—12	28,706,000	1916—17	1,357,000
1912—13	29,435,000	1917—18	15,277,000
1913—14	19,713,000	1918—19	53,000
Total ..	120,292,000		35,984,000

The first reason for this decline in the import of the precious metals was the difficulty of obtaining gold from abroad. The free market in London from where India had obtained gold in the past disappeared at the outbreak of the war. Further the belligerent nations, with a view to maintain their stocks of gold for war purposes, restricted the export of that metal.

This dearth of gold created a strong demand for silver which, for the reasons stated below, could not be obtained in a sufficient quantity. Since the outbreak of the war the world production of silver decreased much mainly owing to the political disturbances in Mexico which was a principal silver-producing country of the world. The production of silver in Mexico fell from an average of 73,937,000 fine ounces for the years 1910-13 to an average of 30,292,000 in the years 1914-17*. Under these circumstances the price of silver would have

*Report of the Babington-Smith Committee, para. 15.

risen appreciably, even had the demand for silver remained normal. But this demand increased considerably. In the British Empire alone 108 millions of fine ounces of silver were required for coinage between 1915-1918 against 30·5 million of fine ounces in the years 1910-1913. The demand of China also showed a great increase; and that was the case also with many other countries. We have stated before that in India also at this time there was a heavy balance of trade and shortage of import of silver; there was a heavy sale of the Council Drafts. To enable the Government to encash them, they had to purchase an unusually large amount of silver. An idea of the large amount of silver purchased could be gathered from the fact that between April 1916 and March 1919 over 500,000,000 ounces were purchased against 180,000,000 standard ounces purchased between April 1904 and March 1907.

These large purchases by India, the decrease in the supply of silver and the increased demand from quarters which had formerly little need for silver were responsible for the rapid and unprecedented rise in the price of silver.

Table showing the rise of price

Years	Prices
1915	27 ¹ / ₄ d. per standard ounce
1916 (April)	35 ¹ / ₈ d. " "
1917 (August)	43d. " "
1917 (September)	55d. " "
1919 (May)	58d. " "
1919 (December)	78d. " "

When the price of a standard ounce of silver is 43d. the exchange value of rupee at 1s. 4d. is equivalent to its bullion price, and thus the rupee ceases to be a token coin.

Owing to certain controlling measures adopted in America and England to pull down the price of silver it ranged, from May 1918 to April 1919 between $47\frac{3}{4}d.$ and $50d.$ per standard ounce. But as soon as these measures were withdrawn the price rose to $58d.$ in May 1919. With such a high price of silver, and owing to shortage of its supply, the Secretary of State for India could neither offer his drafts to an unlimited amount nor maintain the exchange at $1s. 4d.$ per rupee as the intrinsic value of the rupee became higher than $1s. 4d.$

Remedial Measures

Control of Exchange. The outbreak of the war, as stated above, weakened the exchange; but soon it became strong and continued to be normal till December 1916. From that year onwards, demands for Council Drafts showed a steady increase, so much so that it became evident that, inspite of a large purchase of silver by the Secretary of State for coinage, a continuance of the sales on such a scale would endanger the convertibility of the notes. So the sales of these Drafts were limited. This limitation at a time when there was a strong demand for remittance to India led to a divergence between the market rate of exchange and the rate at which the Drafts were sold. To remedy this evil Council Drafts were sold at a fixed rate, which was at the outset $1s. 4\frac{1}{4}d.$ for immediate telegraphic transfers and the sale was confined to certain specified banks which were required to do business with third parties at prescribed rates. They were also required to finance the export of articles of importance to the Allies. This scheme of Government control constituted a complete departure from the pre-war system of free and unlimited remittance; and though it was disliked by the commercial community, it

brought about the anticipated result. On the conclusion of the armistice, these restrictions were withdrawn and drafts were sold from the 18th September 1919 by open competitive tender, subject to a minimum rate. The amount of drafts offered weekly was fixed on a consideration of the trade demand and the resources of the Government of India.

Raising the Exchange. Owing to the rise in the price of silver the rate of exchange was also raised. This raising was necessary for two reasons. First, the bullion value of the rupee being equivalent to 1s. 4d., when silver sold at 43d. per standard ounce, it became necessary to raise the price of the rupee; otherwise the Government stood to lose. Secondly, if the price of the rupee would not have been raised, it might have been under-valued *i.e.* the rupee would have more value as bullion than as a coin, and consequently might have been melted down and possibly exported. These considerations compelled the Secretary of State to raise the rate of exchange. It rose, as the table below shows, from 1s. 4d. to 2s. 4d.:—

Date of Change	Minimum rate for Immediate Tele- graphic Transfers.
3rd. January, 1917	1s. 4 $\frac{1}{4}$ d.
28th. August, 1917	1s. 5d.
12th. April, 1918	1s. 6d.
13th. May, 1919	1s. 8d.
12th. August, 1919	1s. 10d.
18th. September, 1919	2s. 0d.
22nd. November, 1919	2s. 2d.
12th. December, 1919	2s. 4d.

Purchase of Silver. These modifications, had they stood alone, could have done little to ease the situation; they could have prevented but little the strong

demand for rupees which were needed to meet the large sales of Council Drafts. The Government bought silver, among others, from America under the Pittman Act to the tune of 200,000,000 fine ounces. They also stopped the import of silver on private account on the 3rd. September 1917, hoping that this would lower down the price by increasing the amount available and by the elimination of private competition. But this was not very successful as the world demand remained as strong as ever. The purchase of silver from America eased the situation and enabled the Government of India to pull over a serious financial crisis which would have been brought about by their failure to convert the notes.

Not only was the import of silver prohibited, its export or melting was also declared illegal. From 19th. June, 1917, the use of silver or gold coin for other than currency purposes was declared illegal; and from 3rd. September, 1917, the export of silver coin and bullion was prohibited except under license. This prohibition of export was necessary to prevent the silver from going abroad at a time when it was needed much for home use; *viz.*, to coin new rupees to meet the expanding trade represented by the Council Bills and to ensure the encashment of the currency notes. Want of silver and its increasing demand led the Government to issue small notes of the denominations of Rs. 2½ and Re. 1 and a large number of nickel coins to take the place of small silver coins such as two-anna, four-anna and eight-anna bits. The purpose was to get as much silver as possible for the coinage of rupees.

Acquisition and use of Gold. This shortage of silver, a new and perplexing problem, led the Government to increase their stock of gold as much as

possible. With this object in view, the Government by an ordinance, issued on 29th June, 1917, required all gold imported into India to be sold to them at a price, based on the sterling exchange value of the rupee. The Government, to enable the gold bullion to be converted into sovereigns without delay, opened a branch of the Royal Mint at Bombay in August 1918, and, pending the establishment of the Mint, the gold mohur, a 15-rupee coin of the same weight and fineness as the British sovereign, was minted as an emergency coin to meet the demand for currency during the crisis of 1918. This emergency act brings out very clearly not only the nature of the demand for currency, but also the inability of the Government to meet the demand by any other means. The branch of the Royal Mint was closed in April 1919. Immediately on the outbreak of the War the Government stopped the issue of sovereigns. Owing to this stoppage and restricted supply of and increased demand for gold, the market price of gold rose above its statutory price, *viz.*, Rs. 15. This premium on gold prevented the Government from using sovereigns as currency. During the War the amount of gold which could be obtained in India was limited by restrictions on its export from belligerent countries. The removal of these restrictions (1919) enabled the Government of India to get a larger supply of gold. The Government also bought gold directly from London, the United States and Australia. After the armistice the Government, with a view to make a portion of gold they had obtained available to the public, began to sell gold, the immediate effect of such sales was to bring down the price of gold. The price of English bar gold fell from Rs. 32-12 per tola on the 15th August, 1919 to Rs. 27 per tola on the 22nd September, 1919. In December of the same year it stood at

Rs 28·5 per tola.

Increase of note-issue. To meet the difficulties of obtaining sufficient quantities of silver and gold for coinage and as backing for the issue of additional notes, the Government increased the fiduciary portion of the note-issue from 14 crores to Rs. 120 crores, of which 20 crores might be invested in the securities of the Government of India. The gross circulation of currency notes rose from Rs. 66, 12 lakhs in 1914 to Rs. 179, 67 lakhs in November 1919. The issue of paper currency was further extended by the issue of Rs. 2½ and one-rupee notes. From 1916 the absorption of rupees was very large; on the 1st. April 1918 the rupee balances fell to under 10½ crores. The unfavourable war news in March and April 1918 caused a heavy run on the currency offices for the encashment of notes. Inconvertibility appeared to be inevitable and was only averted by the timely announcement of the purchase of silver under the Pittman Act from America. This aspect of the question will be dwelt upon more fully in the Chapter on Paper Currency. They also restricted the facilities for their encashment, and this they had to do inspite of the large purchase of silver from America under the Pittman Act. Facilities for the encashment of notes at the district treasuries were in a large degree withdrawn; conveyance of specie by rail and river steamer and transmission by post were prohibited. Finally in January 1919, owing to practical administrative difficulties in allowing the encashment of notes in full, the daily issue of rupees was limited. The result was the substitution of a large number of notes for rupees as the common circulating medium. The extent of this substitution cannot be definitely ascertained; but the Babington Smith Committee found that in many parts of the

country notes, particularly the one-rupee and 2½ rupee notes, went to a discount.

Financial measures. Other measures, taken by the Government, were to keep down the expenditure as low as possible. Additional taxation was also levied, and extensive borrowing was resorted to in 1917, 1918 and 1919, yielding about 130 crores. Finally from October 1917 short-term Treasury Bills were issued in considerable quantities.

Summary. The position in 1919, when the Babington Smith Committee was appointed to go over the whole question, was summed up by the Committee as follows :—

Council Drafts were sold at 2s. 4d. sterling : the Government had announced their intention to sell, whenever necessary, reverse telegraphic transfers at 2s. 3½d. All gold imported into India was sold to the Government at a prescribed rate. The sovereign was legal tender for Rs. 15, and the Government were under an obligation to pay Rs. 15 for a sovereign presented for encashment. But as the market price, owing to shortage of supply, was much higher than Rs. 15, sovereigns had disappeared from circulation. The import and export of silver were prohibited and its price was so high that purchase at that price for coinage purposes was a loss.

The Committee from a review of the facts stated above concluded that the system, built since 1893, had worked well and had been beneficial to India. It had supplied suitable media for internal circulation, provided means for the settlement of the balance of trade and had secured stability between the rupee and sterling which until 1918 was equivalent to gold. But the system, in the opinion

of the Committee, was not proof against a great rise in the value of silver. The unprecedented rise in the value of silver could not be anticipated by the earlier committees and had raised new questions which the Committee were called upon to answer.

Chapter X

BABINGTON SMITH COMMITTEE

Appointment of the Committee and the scope of its enquiry

A new Committee, the fourth of its kind, was appointed on the 3rd May 1919 with Sir H. Babington Smith as its Chairman and Mr. D. M. Dalal (afterwards Sir D. M. Dalal and the first High Commissioner for India) as the only Indian member. The scope of their enquiry was to examine the effect of the War on the Indian exchange, on the currency system and practice and upon the position of the Indian note issue; and to consider whether, in the light of this experience and of possible future variations in the price of silver, modifications of the system or practice were required; and to make recommendations as to such modifications and generally as to the policy that should be pursued with a view to meeting the requirements of trade, to maintaining a satisfactory monetary circulation and to ensuring a stable gold exchange standard.

In the preceding chapter we dealt with the first part of this enquiry, *viz.*, the effect of the War on the Indian exchange, on the currency system and practice and upon the position of the Indian note-issue. In the following pages we shall deal with the rest of the enquiry and present the view of the Committee which submitted their report in December 1919.

Stability of Exchange

The Committee first discussed the necessity and

advantage of a stable exchange. From the evidence placed before them the Committee found that for 20 years, from 1898 to 1917, India had derived substantial benefit from the stability of exchange at 1s. 4d. per rupee. Though trade had flourished and could flourish with a fluctuating exchange, such an exchange would always introduce elements of speculation which might be overcome but which would surely disturb the smooth growth of trade. For a time a high rise in exchange, as was the case in 1919, might tend to stimulate imports and check exports; while the reverse effect was likely to be produced by a fall in exchange. When there is a rise in exchange, *i.e.*, a rise in the value of the rupee—in 1919 the value of the rupee rose from 1s. 4d. to 2s. 4d.—India gets less silver for her export than she does at a time of low exchange. Thus in 1914, when the price of the rupee was 1s. 4d., one sovereign was worth Rs. 15. But in 1919, the exchange having risen to 2s. 4d., for articles worth one sovereign India got Rs. 10 only. Thus for an amount of produce which brings Rs. 15 when the price of the rupee is 1s. 4d., India will get only Rs. 10 when the price has risen to 2s. 4d. As the amount of silver that India gets for her export falls, prices fall and profits decrease because wages do not fall immediately. Owing to the fall in profits, business is contracted and exports fall off. On the other hand for an article worth £1 India will pay only Rs. 10 when exchange stands at 2s. but at 16d. as much as Rs. 15 would be required for the same transaction. But in course of time wages will fall and profits will consequently rise and the need of importing articles will cease; the country will produce, being stimulated now by fair profits, those articles which it imported formerly. Similarly exports are stimulated

when exchange falls. This train of reasoning was explained in Chapter V. The point to notice is that such an increase in imports or exports is only temporary ; in course of time wages will adjust themselves to prices, and then the elements of gain or loss will disappear. But the adjustment takes time to come about, and, in the opinion of the Committee, the process of adjustment is a difficult one and causes severe strain in the social fabric.

A stable exchange, as we have learnt already, the Committee held, would induce foreigners to invest capital in India; though the Committee feared that for a few years the amount of foreign capital available for India would be less than before owing to its demand in those countries.

The objection to an unstable exchange gets intensified when the fluctuation of the exchange is brought about not by economic causes but by executive action. The commercial community, in the opinion of the Committee, were prepared to deal with fluctuations in exchange brought about by natural economic laws, but they failed to anticipate a fluctuation caused by executive action. The Committee would always prefer an automatic exchange, falling or rising according to economic causes, to one fixed arbitrarily by state action. From these considerations the Committee concluded that a stable exchange was conducive to the growth of production and trade and to the employment of foreign capital ; that a fluctuating exchange was an evil, and that if a large change had already taken place, it was preferable to fix it at the new level rather than go back to the old rate. To go back to the old rate would mean fluctuation in exchange, a process which it was the object of the Committee to avoid.

Suggested Methods

To fix the exchange in a way that it might remain stable in future was the most important part of the enquiry of the Committee which, as we have seen just now, held the view that the exchange should be established at the new level, rather than at the old level, especially if such a course shortened the period of uncertainty. They turned down the proposals made by some witnesses to establish the exchange either at the old level of 1s. 4d. per rupee or some other level below the exchange then prevailing.

It was proposed that a new rupee with a lower silver content should be coined. It was argued that if that was done, it would not be difficult to maintain the token character of the rupee, in spite of a great rise in the price of silver, and fix the exchange value of the rupee at any level that might be chosen. It should be remembered that the rupee with its face value fixed at 1s. 4d. ceases to be a token coin when the price of silver is 43d. per standard ounce; then the price of the rupee, *i. e.* 1s. 4d. is equivalent to the price of its silver content. It remains a token coin as long as the price of silver is below 43d. per standard ounce; at any price above 43d. per standard ounce not only the rupee ceases to be a token coin, its coinage also entails loss on the Government. The proposal of coining a new rupee with a smaller silver content was dismissed as impracticable, and, in our view, rightly. The Committee pointed out that the rupee had remained unaltered since 1835, and its fineness and weight were known to everyone. Any change in its weight and fineness would shake seriously the credit of the Government and might possibly lead to social and economic upheavals. Further a new rupee, according to Gresham's law, with a lower silver content, would tend to drive out the old rupees from circula-

tion, and the Government would be required to mint a very large number of new rupees to meet the demand for the metallic currency. It would be very difficult to get so much silver either from the existing currency or elsewhere. This proposal, therefore, the Committee were unable to accept. A suggestion of a similar nature that new 2- or 3-rupee pieces of lower proportional silver content than the existing rupee should be issued and allowed to circulate by the side of the rupee and that new coinage might be temporarily suspended was also unacceptable to the Committee for the reason stated already. The old rupees would tend to disappear, and the credit of the Government might also be affected. Further, the Committee thought that 2- or 3-rupee pieces would be inconveniently large for the great bulk of retail transactions in India. For similar reasons they rejected the proposal of coining a new nickel rupee, though they supported the issue of 4 anna and 8 anna nickel coins. Another suggestion—this time put forward by the Government—was to fix the exchange at a rate which would ensure the token character of the rupee; if however, the price of silver should rise higher and the rupee were to lose its token character, the Secretary of State for India, according to this scheme, should suspend the purchase of silver and the notes would become inconvertible. The idea was that a suspension of purchase of silver by India would lead to a fall in the price of silver. The Committee held that there was no such possibility; and they were confirmed in their view by the fact that though for six months the Secretary of State had not purchased any silver, its price, instead of falling, had risen to an unprecedented height. With regard to inconvertibility of notes the Committee held that in India note-issuing had not been established so much as in other countries,

and a failure on the part of the Government to maintain its convertibility would place a considerable discount on notes and shake terribly the credit of the Government. If that was done, it would take many long years, the Committee thought, to put the notes once more into circulation.

Case for a High Exchange

The Committee held that there was little possibility for silver to fall in price in the near future. Professor Cullis, D. Sc., and Professor H. C. H. Carpenter, F.R.S, who were appointed by the Secretary of State for India to conduct an enquiry into the conditions of silver production, suggested in their report that on the restoration of order in Mexico—this disorder was entirely of a local nature and had nothing to do with the War—the pre-war average could be reached. The increased demand for subsidiary coins of base metals with which silver was associated as a bye-product and better methods of extraction might lead, in their opinion, to an increased supply in future. On the other hand, the Committee were of opinion that from the evidence before them it was certain that for some time there would be a high demand for silver. And if China were to continue to buy silver as she did during the War, there would be a very strong demand for silver. With these facts before them the Committee held that it would be difficult to find out definitely the level at which the price of silver was likely to stand in future. The other fact which the Committee took into consideration was that under the Pittman Act the American Government was under an obligation to replace the silver taken out from the Reserves at the price of one dollar per ounce of silver. For this replacement America would require considerably more

than a year's total production of silver and was likely to buy silver for a few years to come. Thus the demand for silver would continue for some years, and the price could not fall below one dollar per fine ounce, the price at which America was to buy silver. In the opinion of the Committee a return of the dollar-sterling exchange to par would not permit the rupee to be minted without loss at this price unless the exchange value of the rupee was fixed at 1s. 6d. or at some higher figure.

When the exchanges were at par, the bullion value of the principal silver coins of the countries named below would be equal to their face value if the prices of silver were:—England 66*d.*; France (5 franc piece), 60³/₄*d.*; and U. S. A (dollar) 59¹/₄*d.*; *i. e.* if the price of silver would rise to 59¹/₄, the dollar would cease to be a token coin. If the price stood at a level higher than the prices mentioned above, it would be a loss to use either the dollar or the five-franc piece as currency; as silver they would fetch more price than as coins. Under these circumstances the French and American silver pieces would run the risk of being melted and exported. If the price of silver was 62·9*d.* per standard ounce, and therefore well above the French and American parity, the corresponding bullion value of the silver in the rupee was 1s. 11·36*d.*, and the cost of the rupee (including all charges) would come upto 2s. From these calculations the Committee were of opinion that if the exchange value of the rupee were fixed at 2s., its token character would be easily maintained and its circulation as currency could also be assured.

Effects of a High Rate of Exchange

The Committee thus concluded that a high rate of exchange was essential for the establishment of a

sound monetary system in India. The Committee then proceeded to discuss the effects of a high exchange on Indian trade, level of prices and prosperity of the people. It was pointed out to the Committee that a high rate of exchange was likely to restrain the rise of prices which had already gone up very high and caused much inconvenience to the people. On the other hand, the harmful effect of a high rate of exchange on trade and the development of Indian industry was emphasised by others.

On the evidence placed before them the Committee found that there had been a great increase in all prices in India during the last few years. The upward movement had begun before the War but became rapid during the last two years, *i.e.*, 1917 and 1918. This was partly due to the widespread failure of crop in 1918; but the main causes were the results of the war, *viz.*, excessive inflation of currency by the creation of a large amount of credit and paper currency, shortage in production and restraints upon free commercial intercourse. Prices, however, rose much higher in England and other countries.

There were so many factors in play in influencing prices that it was difficult, in the opinion of the Committee, to ascertain the part that high rate of exchange played in influencing them. Government control over the movement and prices of foodstuffs, and restrictions on finance and freight prevented the prices from rising higher. On the other hand failure of the crop in 1918 caused prices also to go up. In spite of these conflicting factors, the Committee had no reason to doubt that but for the high level of exchange, prices would have gone much higher up. This argument is easy to understand. A high rate of exchange means a rise in the gold value of the rupee; at 1s. 4d. one

sovereign is equal to Rs. 15 but at 2s. one sovereign is equal to Rs. 10. So when the rate rises, India gets less rupees for her exports than before; and as the amount of money in circulation does not increase, in proportion to the increase of trade, its value increases and prices fall. The sterling price of the imported articles would be represented, when the exchange was high, by a smaller number of rupees and hence such imported goods could be sold in India at a lower price. In the case of exports such as wheat, the sterling price which could be obtained for a given quantity of wheat would, at a high exchange, be represented by a smaller number of rupees and the price which the grower would receive must necessarily be lower. These considerations, however, did not apply to such produce, in the opinion of the Committee, as jute of which India enjoyed a practical monopoly; the producer could exact a higher sterling price here in order that he might receive the same number of rupees. But the Committee held that on jute as well as on food grains which were used for home consumption, the rate of exchange had an indirect effect; it kept down the prices of these articles which thus could not rise to their full extent owing to the high rate of exchange.

The Committee then considered the question whether a high price-level or a low one was beneficial to the people of India. The Committee argued that according to the census of 1911, 217 millions or 72 per cent. of the population, were employed in pasture and agriculture. Of this number 167 millions cultivated their own land and of these such as had a surplus to sell would ordinarily gain by the rise in prices, though they had to pay higher prices for piece-

*See page 542—45.

goods and other necessities of life. On the other hand those who had no surplus to sell and who lived on what they produced were unaffected by a rise in the price of food-stuffs; though they had to pay a much higher price for the necessities of life.

The farm servants and field labourers, who numbered 41 millions in 1911, lost by a rise in prices except in so far as their wages were payable in kind and not in money. The large class of persons with fixed incomes were the persons to suffer most heavily. Industrial wage-earning labourers and domestic servants had been able to obtain increased wages, but the evidence, which the Committee had before them, showed that the wages did not rise so much as the prices. The opinion of the Government of India, quoted by the Committee, supported this view. The Committee concluded that a low price and hence a high rate of exchange were beneficial on economic and social grounds to the people of India; a low exchange would raise the prices and aggravate the dangers of social and economic discontent. A high exchange had mitigated the sufferings of the people by keeping down prices, and it was, therefore, desirable, the Committee concluded, to fix the exchange at a high level. In the words of the Committee :

“ The rise in prices in India has now reached a point at which it is injurious to the country as a whole, and we believe that any measures tending either to reduce prices or check a further increase would be beneficial to the mass of the population.”

On Trade. The effects of a high rate of exchange on trade, as stated above, would be, in the first instance, to stimulate imports and check exports; but these effects are always of a temporary nature. The Committee held that India's trade had been in a prosperous

condition for some years past and would remain so for at least a few years more owing to the world shortage of raw materials and foodstuffs. At the same time, owing to the great rise in the level of prices in those countries which would import Indian commodities, the Indian producers would be able to obtain a favourable price for their produce. Further, the cost of imported stores and machinery would be low as measured in rupees, and, as pointed out already, a high exchange would keep down the cost of living and wages.

The Committee held that a high rate of exchange would not do permanent injury to Indian Trade, though new questions were likely to arise and might call for new remedies if suddenly the level of prices were to fall in future.

On India Industry. Though imports were likely to be stimulated by the high rate of exchange, it was not likely to hamper seriously the development of Indian industry. Such stimulation would be temporary, and, in the period which might elapse before the adjustment of prices and other conditions to the new level would be complete, such imports would not be very large in amount owing to the greatly increased cost of their production in the exporting countries. Further a high rate of exchange would keep down the cost for wages and raw materials in India, and, as far as nascent industries were concerned, the low rupee price of machinery, plant and stores would be of great advantage.

On Home charges. The advantage of a high rate, as far as the Home Charges were concerned, was clearly favourable. The reason for closing the mints in 1893 was to stop the exchange from falling too low and the fixing of the exchange at 1s. 4d. had

materially improved the position of the Government of India and had saved the necessity of levying additional taxation which otherwise might have been necessary. Calculating the Home charges on an average at £25,000,000 per annum, India would require $37\frac{1}{2}$ crores of rupees, if the exchange would stand at 1s. 4d; but with the exchange at 2s., only 25 crores would be required. Clearly there would be a great saving which would amount to $12\frac{1}{2}$ crores a year. But there would be loss in re-valuating the sterling investments and the gold in the Paper Currency. At 2s. per rupee the loss on this score would amount to 38.4 crores, but this could be made good in three years from the revenue saved in respect of the Home Charges. After this had been done, there would be a considerable surplus revenue which might be employed either in the development of India or in the reduction of taxation.

The Committee, taking all these views into consideration, found in favour of a high rate of exchange. Such a rate, in the opinion of the Committee, was not likely to injure the material interests of India; on the contrary it might bring about certain advantages.

Rupee and Gold

Having found that a high rate of exchange would be advantageous to India, the Committee decided that the relation of the rupee should be fixed not with sterling, as was then the case, but with gold. Before the War there was perfect convertibility of the sterling into gold: sovereigns and half-sovereigns were in circulation, and Bank of England notes and other Bank notes, which formed the major part of the currency in England, were convertible into gold. Then there was no necessity for making any distinction

between sterling and gold. After the War, however, gold coin ceased to be the currency in England; Treasury notes which were full legal tender were not convertible in gold. The result was that there came to exist a divergence between sterling and sovereign; one hundred ounces of gold would be coined into 425 sovereigns, but at the quotation of 17th December 1919, (108s. 9d. per oz.) 100 ounces of fine gold cost £544 in sterling i.e. notes. Thus one pound sterling (paper) was equivalent to $\frac{425}{544}$ or .78 of the sovereign (gold), a discount of 22 per cent; or conversely the sovereign was worth $\frac{544}{425}$ or 1.28 sterling (paper), a premium of 28 per cent. There was a corresponding depreciation between the sterling and the American dollar which was convertible into gold. The gold sovereign was equivalent to \$ 4.8666; while the pound sterling was quoted on 17th December 1919 at \$ 3.83, a depreciation of over 21 per cent. It was, therefore, necessary to consider whether, if the rupee was to be stabilised, it should be related with sterling (paper) or gold.

Case for sterling The main argument in favour of rupee-sterling exchange was that, as the larger part of the trade of India was with sterling-using countries, rupee-sterling exchange would be advantageous to India. During the year 1918-1919 trade of India with those parts of British Empire which used sterling amounted to 40 per cent for exports and 48 per cent for imports and with gold-using countries (Japan and America) to 25 per cent. for exports and 30 per cent. for imports, of the total exports and imports of India. It was argued that the advantage of the fixity of exchange, in case the rupee was linked with sterling, would be retained for the major part of Indian trade, and such an exchange would promote trade within the Empire. The Committee admitted the

weight of this contention but held that a fluctuating sterling exchange would not hamper trade between the United Kingdom and India, provided trade requirements for remittance were met freely and fully. Moreover, the fluctuation of the rupee-sterling exchange would last only so long as the gold basis of the British currency could not be restored. Evidently the Committee hoped that at an early date the gold basis would be restored in England.

Case for gold. (1) A depreciated currency like the English Currency (sterling) had many inconveniences which would be intensified on further depreciation. To link Indian currency to a depreciating one was to invite all those inconveniences.

2. In the opinion of the Committee the stability of the rupee was to be fixed at an early date at a level which would maintain the token character of the rupee and make unnecessary a further increase in its value. A further depreciation of the sterling would necessitate such an increase and make, if the rupee was to be related with sterling, exchange again unstable; but if the value of the rupee could be fixed with relation to gold, this disturbing element would be eliminated; because in that case a rise in the sterling price of silver resulting from further depreciation of sterling would be offset by a similar automatic rise in the sterling value of the rupee.

3. If the value of the rupee was fixed in sterling in such a way that the token character of the rupee might be maintained, such a value would be very high. If in the course of the next few years sterling once more became equivalent to gold, the rupee-sterling exchange might be found to be very high; but the stabilisation of the rupee with gold could be made at a much lower figure.

4. As in India, at least for a few years to come,

both the rupee and the sovereign were to remain unlimited legal tender and were to be used as currency, it was of essential importance that the relation of the rupee should be fixed with gold. These two coins could not remain in circulation as unlimited legal tender with a variable relation—a result which was sure to be produced by fixing the value of the rupee with sterling. Sovereign in that case would be a token coin in India, divorced from its bullion value.

The Committee concluded that for these reasons the exchange value of the rupee should be fixed in terms of gold.

The Committee also were of the opinion that the rate of exchange should be fixed at once in compliance with their terms of reference and held that the postponement of this decision would mean the continuance of the existing uncertainty and would prolong the Government control over exchange and over the imports of the precious metals into India. It was pointed out to the Committee, among others by Sir Lionel Abraham, Assistant Under Secretary of State for India, that conditions existing in 1919 were abnormal and it would be difficult to ascertain how things would take their turn in future. The Committee were asked, on this account alone, to postpone their decision and wait upon 'events'. Though the Committee admitted the force of this argument, they refused to accept it. But the subsequent events showed that the Committee would have done well to listen to their advice and postpone their decision till normal times had come. The decisions of the Committee were very hasty. War was then just over and the abnormal state of affairs, created by it was passing off. The Committee admitted that "the present circumstances are abnormal," but they were anxious to ensure "a stable gold exchange standard."

and, in their anxiety to do so, they refused to listen to sober advice. On the very day the report was published, the tide of affairs took a different turn; export fell and imports increased, and the balance of trade turned against India.

The Rate Recommended

The Committee recommended that for the establishment of a stable relation between the rupee and gold the rate should be fixed at the ratio of ten rupees to one sovereign. This ratio would, according to the Committee, maintain the token character of the rupee and re-establish the automatic working of the currency system. In the opinion of the Committee there was likelihood for the price of silver to rise to a higher point; in the case of a still further rise, the Government should diminish the demand for currency by reducing the sale of Council Bills, relying on the free import of gold and silver. The Government of India should try, in such a case, to meet the demand for metallic currency by the use of gold. The Committee in this connection discouraged the idea of impairing the convertibility of the note-issue. The steps to be taken to give effect to these recommendations should be:—

1. A Notification changing the present acquisition rate for imported gold and fixing it at the rate of Rs. 10 per sovereign;

2. An amendment of the Indian Paper Currency Act and Indian Coinage Act, so as to make the sovereign a legal tender for Rs. 10 instead of for Rs. 15, and

3. The withdrawal of the existing undertaking to give Rs. 15 for a sovereign.

Council Drafts and Reverse Bills

The Committee accepted the view of the Chamberlain Commission with regard to the function of the Council Drafts (see Chapter VIII). There was no obligation for the Secretary of State held the Committee to sell Council Bills to meet all trade demands. If the recommendations of the Committee were accepted with regard to the free import and export of gold, a settlement of the balance of trade in favour of India could be made by export of gold to India. If, however, the Secretary of State could with advantage sell his drafts in excess of his requirements when there was a demand for them in the opinion of the Committee, he should be allowed to do so. These recommendations of the Committee referred to normal times when silver could be purchased readily. During abnormal times when it would be difficult to purchase silver, as it was in 1919, the practice of selling drafts weekly with reference to the requirements of the Secretary of State and the capacity of the Government of India to meet them should be followed. The minimum rate might be fixed from time to time on the basis of the sterling cost of shipping gold to India. They also recommended that the Government should be authorised to announce, without the previous sanction of the Secretary of State (such sanction had taken much time in the past), their readiness to sell weekly a stated amount of Reverse Councils, including telegraphic transfers, during periods of exchange weakness.

Precious Metals, their Exports and Imports.

The Committee did not support the view that an undue proportion of the world's gold had been absorbed in India; the annual import of gold coin and bullion on the average of five years preceding the War was about £19,000,000. Considering the fact

that the population of India in 1911 exceeded 315 millions, the annual absorption did not appear to the Committee to be exorbitant.

India's capacity to draw gold from other countries depended, in the last resort, on the desire of her customers to purchase her produce, and, as the balance of trade had been in her favour, she had a right to require payment in the form she liked. The Committee, however, discouraged the hoarding habit and recommended that proper facilities should be offered to the people for the deposit and investment of their savings.

As regards the import and export of gold the Committee recommended the repeal of the Gold Import Act, passed in 1917, which compelled all imported gold to be sold to the Government at a specified price. Though export of gold was not prohibited, it was not exported, as in India gold commanded a premium. In the opinion of the Committee there should be free entry of gold, which would be secured by the repeal of the Gold Import Act. With the free entry of gold, the premium on gold would disappear, and there would be free movement of gold to and from India.

Gold Currency. With the fixation of the rupee in terms of gold and the disappearance of the internal premium on gold there was every likelihood of gold circulating as currency. The Committee agreed with the views of the Chamberlain Commission that the Government should continue to aim at giving the people the form of currency they would require, that the best currency for internal use should be rupees and notes and that it was not to India's advantage to increase, for internal purpose, the use of gold. They, however, held that for some years to come, it would be difficult to meet all metallic demand in rupees, and hence the Government should

have to use gold to meet this demand, particularly for the encashment of notes. Even when the difficulties to buy silver might not be felt, there might be a demand in certain parts of India for gold, and the Committee recommended the pre-war practice of putting gold into circulation, whenever they might be called upon to do so. To make gold available for the currency the Committee recommended that the branch of the Royal Mint, closed during the War, should be reopened for the coinage of sovereigns and half-sovereigns, and that the Government should announce their intention to receive gold bullion, whether refined or not, and issue gold sovereigns for 113·0016 grains of fine gold subject to a small coinage charge.

In view of the shortage of silver the Committee recommended the withdrawal of the obligation to give rupees for sovereigns. The fixing of the price of the rupee at the rate of 10 Rs. for one sovereign would entail heavy loss on the holders of the sovereigns. Though there was no legal obligation for the Government to indemnify such holders, the Committee thought that reasonable opportunities should be given to these holders to exchange their sovereigns at the rate of Rs. 15 for one £.

Silver. With regard to silver the Committee held that the restrictions on the import of silver and the import duty on silver should be removed. Owing to the prohibition of import of silver there had not been any revenue from that source, though before the War the revenue from this source amounted to one crore of rupees annually. The abolition of this duty would not involve, therefore, any readjustment of taxation. Further the abolition of the duty would facilitate the creation of a world market for silver in Bombay and place the Indian consumers on the same level as the people of other countries. The Committee, however, could not

recommend the abolition of the control over export of silver. As long as the exchange value of the rupee was equivalent to its silver content, there would remain a great temptation for the people to melt and export it as such a transaction would be clearly profitable.

Gold Standard Reserve

The Committee also accepted the view of the Chamberlain Commission that there should be no limit to the Gold Standard Reserve. As soon as profits would accrue on the coinage of rupees, they should be credited to the reserve. The silver branch of the Gold Standard Reserve was abolished, in pursuance of the recommendations of the Chamberlain Commission, in 1915. The Chamberlain Commission recommended that the total gold holding should be raised to £15,000,000 at an early date and that the authorities thereafter should aim at keeping one-half of the total reserve in actual gold. This recommendation, as will be clear from the table below, was not carried out by the Government of India:—

Composition of the Reserve

on 30th November, 1919.

	£
British Treasury Bills maturing between December 1919 and March 1920.	8,219,000
Exchequer Bonds, redeemable between February 1920 and October 1921	16,199,300
National War Bonds, redeemable 1st October, 1922	7,500,000
Five per cent. War loan 1929—47	3,762,181
Local Loans, 3 per cent. Stock	200,000
Irish Land Stock, 2 ³ / ₄ per cent.	438,720
Transvaal Government 3 per cent.	

Guaranteed stocks, 1923—53	...	1,092,023
		<hr/>
		37,411,224
Cash		27,093
		<hr/>
		37,438,317

Thus the reserve was held almost entirely in securities. Though the Committee agreed to the principle that the reserve should be held mainly in gold, they thought that under the conditions then prevailing a large gold holding could not be secured for some years and that the most satisfactory course would be to keep the Reserve as liquid as possible. The composition of the Reserve, as it stood on the 30th November 1919, in the view of the Committee, was satisfactory as it was invested, with the exception of £5,500,000, in securities which were redeemable by October 1922.

As far as the location of the Reserve was concerned the Committee held that as the Reserve would be required to meet the sterling remittance (Reverse Bills) to London in case of a fall of exchange, the proper place where the Reserve should be kept was London. But in view of the fact that there was a strong opinion in India in favour of the location of the Reserve in India, the Committee recommended that a portion of the gold in the Reserve should be kept in India.

Note of Dissent

Mr. Dalal differed entirely from the views of the Committee and held that the reason given for raising the rate of exchange was inadequate, that the high rate of exchange would bring about a revolution in the currency system of the country, that the rise in the price of silver was artificial and that the gold exchange standard had entirely broken down and was discredited as a currency system.

Breakdown of the standard ratio between rupees and sovereigns. In Mr. Dalal's opinion the cardinal feature of the Indian currency system was the fixed relation of the rupee with the sovereign established, as the reader remembers, as early as 1893. In that year the mints were closed to the free coinage of silver and the silver standard was given up. In 1898, the silver standard was replaced by a gold standard with British sovereigns and half-sovereigns as unlimited legal tender, *rupees being connected definitely with gold* at the ratio of 15 to 1. It mattered little whether the standard was called gold standard or exchange standard; the outstanding fact was that *India had been placed on a gold basis* definitely related to sovereign at a fixed ratio with the rupee. The Indians had come to measure the value of their goods, possession and labour according to this standard, and without very strong reason this standard should never be changed. The European countries with a view to finance the War had to take to artificial inflation of their currencies; but Indian inflation was genuine as it was necessary to liquidate the balance of trade indebtedness to India, and this had to be done because there was no other way on the part of foreign nations to liquidate the balance. This was unfortunate and led to the breakdown of the system; because heavy Council Bills were sold and to meet them an equally heavy currency was required. Owing to the rise in the price of silver the old ratio could not be maintained and was raised by stages from 1s. 4d. to 2s.4d. The excess of exports over imports are paid for usually by two methods, *viz.*, sale Council Bills and the importation of precious metals. During the War, owing to the shortage of these metals, the only method left was to sell the Bills. The sales of the Bills required a large coinage; owing to shortage in the supply of silver and

demand for it from quarters which did not require silver before, the price of silver had already gone up. The demand of the Government of India to meet the Council Bills raised the price still further. The best course would have been, under these circumstances, to float British Government loans in India as it was done in the United States *Note-issue*. Mr. Dalal condemned the huge amount of fiduciary note-issue which, he held, was a forced loan from the Indian public free from interest. It was an extreme measure, particularly at a time when there were immense sums lying in London belonging to the Indian currency. The notes were becoming inconvertible, and an actual state of inconvertibility was avoided by the narrowest margin. Mr. Dalal held that inconvertibility would have been a disaster of first grade magnitude and would have destroyed all confidence in Government's own paper money. Owing to the restriction placed on the encashment of the currency notes, already referred, they went to a discount, and a discount on the currency notes was a very vicious thing. The internal trade of India, according to the evidence of Mr. E. M. Cook, C. I. E., of the Finance Department was fifteen times larger than the external trade and thus there was immense possibility to extend and popularise the note-issue. But the first essential to ensure note-issue was to create confidence in the minds of the people by the readiness of the Government to redeem them into the standard coins.

Price of Silver. In the opinion of Mr. Dalal the high price of silver (it was highest at the time the report was being written, *viz.*, 78d. per ounce) was due, in the first place, to the prohibition of exports of silver from India. This prohibition decreased the amount of silver available and raised its price. In the second place the raising of the exchange lowered the rupee value of all silver and consequently made exports of

silver unprofitable. The objection to the removal of the prohibitory order was that such a removal would deplete the silver currency by exports abroad. In a country like India where the amount of silver currency was much in excess of the quantity in circulation, the removal of the prohibition would not have caused any disturbance; there was no necessity to coin new rupees for a few years. As regards the note-issue, for the encashment of which silver was essential, Mr. Dalal held that the whole position was artificial. We have already discussed his views on this point.

Even if the export of silver could not be allowed, Mr. Dalal held that there was no occasion for raising the exchange. India, as already stated, had more than enough of silver currency and could have carried on her work without any silver coinage for ten years. The best course for the Government to follow would have been to stop the coinage of rupees when such coinage became unprofitable owing to the rise in the price of silver and to allow, at the same time, the trade balance to be settled by means other than import of silver. But the Government went on selling Council Bills, and when the old ratio could not be maintained, a new higher ratio had to be fixed.

Another method of avoiding the raising of the exchange would have been to impose duty on all exports; such a duty would have enabled the Government to meet the additional cost of buying silver at a higher price and would have also the effect of moderating foreign demand for Indian produce and thus decreasing the balance of trade due to India. Mr. Dalal would have preferred a debased coin to raising the exchange and questioned whether the Government of India had the right by executive authority to disturb the legally established monetary system. Mr. Dalal also held that there was no advantage in raising the exchange

with a corresponding rise in the price of silver. One advantage claimed in former years for issuing rupees instead of sovereigns was that it was economical; the rise in the price of silver took away that advantage.

The third objection, which was of a more vital nature than the others, was that the export of silver would have increased the balance of trade in favour of India and made the situation more critical. With silver exports, it would have been difficult to settle the balance of trade with the sale of Council Bills; it must have been settled, in that case, by the import of gold. The exports of silver from India, in the language of Mr. Dalal, would have broken the strength of the silver market and prevented the rise in the price of silver. As a check to the rise in the price of silver would have been profitable to India, it would have been better if her trade balances had been paid for in gold. The American Government had offered to sell silver currency when the price of silver rose above the bullion value of the dollars with the obvious object of preventing further rise of silver. Mr. Dalal suggested that the same could have been done in India.

Council Bills. According to Mr. Dalal Council Bills should be sold only to meet the requirements of the Government; they should not be sold to meet the requirements of trade. In no other countries the Governments tried to provide machinery for meeting the balances; the same thing should be done in India. "The concern of the Government should be to protect and safeguard the interests of the people as a whole in the maintenance of the legally settled standard and I consider that the Government would be performing its duty better by paying more attention to this aspect of the question than by showing anxiety for trade requirements." (From Mr. Dalal's Note of Dissent.)

Chapter XI

INDIAN PAPER CURRENCY

Indian paper currency, as it stands to-day, has a long history behind it, dating as far back as the 18th century. This history is generally divided into three distinct stages, one stage leading to the other and each having its own peculiarities. The first stage ended in 1861, the second stage extended from 1861 to 1919; it is now in its third stage.

First stage, upto 1861.

Till the year 1861 notes were issued by the three Presidency Banks and a few other private banks. The Government had nothing to do with the issue of currency notes. The circulation of these notes was practically confined to the three Presidency towns of Calcutta, Bombay and Madras. These notes were not legal tender. By far the most important of these banks were the three Presidency Banks which were allowed by Charters to issue notes in all upto the maximum amount of 5 crores of rupees against which they were to hold one-fourth in specie. The circulation of these notes was very limited in amount, as, in the first place, they were not legal tender, and, in the second place, they could hardly be converted into rupees at a distance from the Presidency towns. Thus it is computed that in 1861 when the power of issuing notes was taken over by the Government, the Bank of Bengal had a note issue of only Rs. 137 lakhs. The Bank of Bombay had its circulation limited by an Act to Rs. 2 crores; it, however, never issued notes of more than Rs. 128 lakhs in value. Similarly the Bank of

Madras was allowed to issue notes up to a maximum limit of one crore of rupees; though its actual note-issue was always below this statutory limit*.

Second Stage, 1861—1919.

In the year 1861 after a good deal of hesitation and careful consideration the Government by virtue of an Act passed in 1861 (Act XIX of 1861) deprived all banks of the right of note-issue and provided for the issue of a paper currency through a Government Department by means of notes payable to bearer on demand. The Act also divided the whole country into four circles, each containing one city which became the place of the issue of notes in that circle. The Government were empowered to issue notes without limit against rupee or gold.

Until 1910 these notes were legal tender only within the circle of issue and were legally encashable only at the office at the headquarters of the circle of issue or at the Paper Currency Office at the Presidency town of the Presidency in which the circle was situated. For the accommodation of the public, however, the notes of other circles could be cashed at any paper currency office or at any Government treasury, provided such encashment could be done without any inconvenience. The Act also required that a metallic reserve, called the Paper Currency Reserve, was to be kept against the whole of the notes issued, with the exception of such amount not exceeding 4 crores of rupees, as might be fixed by the Governor-General in Council with the consent of the Secretary of State for India. This amount was to be invested in Government securities.

Thus was laid the foundation of the Indian Paper Currency based on the principles of the English

*Findlay Shirras, Indian Finance and Banking, Chapter VIII, page 240.

Bank Charter Act of 1844. The principles underlying the Bank Charter Act of 1844 has already been explained in a previous Chapter and need not be reiterated here.

Thus we find in the first instance that the fiduciary portion was strictly limited and very small. The object was to prevent issue of notes in excess of public requirements. In the opinion of the orthodox school an over-issue of paper currency was regarded as a great evil, and the only method to prevent an over-issue was, it was believed, to make the notes readily convertible into metallic currency and to keep an adequate metallic reserve against it. Thus the Act of 1861 not only aimed at making the notes readily convertible into metal but went a little further; it made the paper money identical with the metallic circulation which the paper issue was to displace. The greatest defect of such a system was to make paper money *inelastic*. The issue of notes, over and above the fiduciary portion which was fixed at the low figure of 4 crores of rupees, required an equivalent metallic backing and consequently was as expensive as the issue of silver or gold coins. In the second instance by making the notes legal tender and encashable only in their respective circles the usefulness and popularity of the notes were very much limited, and for the first forty years of their existence the currency notes occupied only a minor place in the currency system of the country*. But the Government, as pointed out by Mr. Keynes, had their reasons in adopting the system of circles. India was a vast country with very inadequate means of communication in those days, and the people were ignorant of the benefits of a paper currency; if in these circumstances the Government would have undertaken the task of encashing the notes a

* Keynes, *Indian Currency and Banking*, p. 40.

numerous places in the country, they would have been faced with serious difficulties in moving the coins from place to place. On the contrary, if the notes would have been made universal legal tender but encashable only at Presidency towns, the notes would have undoubtedly gone to a discount in certain seasons of the year.

Changes from 1861 to 1914.

The paper currency expanded but slowly for a long time on the lines laid down by the Act of 1861 for the reasons stated above. The period from 1861 to 1914, however, saw three important changes in the currency system of our country. In the first place, the fiduciary portion was increased by stages from 4 to 14 crores in 1911; this was the figure at which the invested portion stood at the outbreak of the War. This increase of the fiduciary portion introduced a little elasticity into a rigidly inelastic system. In the second place, a new branch of the Paper Currency, the London branch, was created in 1905. In the third place, notes of smaller denominations were universalised, an act which made the notes more popular than before and increased appreciably their circulation. The effect of these changes was to increase the gross note circulation from 8 crores of rupees in the first decennial period ending 1871 to 66 crores in 1914.

Coming to details we find that the fiduciary portion was increased from 4 crores to 6 crores in 1871, to 8 crores in 1890, to 10 crores in 1896, to 12 crores in 1905 and to 14 crores in 1911.

By an act of 1882 the Paper Currency Act was extended to Burma, so long excluded from the operations of the Act of 1861. In 1898 an Act was passed, known as the Gold Note Act, empowering the Government to issue notes in India on the security of gold

deposited in London. This Act which was a temporary one was made permanent in 1902.

In 1903 the 5-rupee note was made a legal tender throughout British India (except in Burma) and was made encashable at any office of issue. It was made a legal tender in Burma in 1909. By Act III of 1905 the Government were permitted to hold the reserve in rupees, gold coins, bullion or securities either in India or in London; coined rupees were, however, to be kept in India alone and out of 12 crores of the invested portion 2 crores might be invested in the securities of the United Kingdom. By Virtue of this Act a branch of the Paper Currency Reserve was instituted in London in 1905 and by 1906 two-thirds of the gold that had been accumulated upto that time in the Paper Currency Reserve in India was transferred to London. This stock was kept in the Bank of England and was said to be "ear-marked." In 1910, by Act II of that year, 5, 10 and 50 rupee-notes were universalised. The same Act divided the whole of India into 7 circles in place of 4 with their headquarters at Calcutta, Bombay, Madras, Rangoon, Karachi, Cawnpur and Lahore. Finally in 1911 the 100 rupee currency note was universalised by Notification in the Gazette of India. The following table gives us the composition and location of the Paper Currency Reserve upto March 1914 :—

COMPOSITION AND LOCATION OF PAPER CURRENCY RESERVE

Composition and Location of the Reserve (in lakhs of rupees).

Last day of March.	Total note- issue.	Silver.	Gold.			Securities.		
		India.	India.	England.	Total.	India.	England.	Total.
1862—1872	7,63	4,80	3	...	3	2,80		2,80
1872—1881	11,82	5,98	...	...	..	5,84		5,84
1882—1891	15,74	9,64	...	...	...	6,10	...	6,10
1892—1901	27,29	15,74	2,32	23	2,55	9,00	...	9,00
1902—1911	43,82	19,45	9,15	4,02	13,17	10,00	1,20	11,20
1912	61,36	15,48	23,33	8,55	31,88	10,00	4,00	14,00
1913	68,98	16,45	29,38	9,15	38,53	10,00	4,00	14,00
1914	66,12	29,53	22,44	9,15	31,59	10,00	4,00	14,00

Looking down the table we notice that the note circulation rose from 8 crores in the first decennial period ending 1871 to 66 crores in 1914. This circulation was backed partly by silver and partly by securities till 1897 (except a small amount of gold held in India from 1865 to 1875) when the amount of silver rose to 14 crores and securities to 10 crores or 58 and 42 per cent. of the total reserve respectively. In 1914 the silver portion amounted to 20½ crores and securities to 14 crores of rupees.

Chamberlain Commission. With these facts before them the Chamberlain Commission, appointed in 1914, examined the whole currency system of India and found among other things, *that the Indian paper currency was extremely inelastic.* The Commission held that a more elastic system was required to meet the expansion of trade and suggested the following methods:—

1. That the fiduciary portion of the note-issue should be increased at once to rupees 20 crores and thereafter fixed at a maximum of the amount of notes held by Government in the Reserve Treasuries *plus* one-third of the net circulation, and that the Government should take power to make temporary investment or loan from the fiduciary portion within this maximum in India and London, as an alternative to investment in permanent securities.

The practice of thus lending money temporarily would result, the Commission pointed out, in certain advantages. Firstly, such temporary loans in the busy season of the year would help the money market with an expansion of currency and thus were likely to give some relief to the seasonal monetary stringency. Secondly, the Government would be able by such loan operations to earn a considerable profit. Thirdly, the Government would be able, as the note circulation would

increase, to add to the temporary or permanent investment of the Reserve without the help of any legislation. Lastly the power to make temporary investment in London on account of the Paper Currency Reserve would be a convenience to the Secretary of State in permitting him to sell Council Bills against the Paper Currency Reserve in anticipation of silver purchases or any other cause without the loss of any interest and other disadvantages which sometimes might come about if he were compelled, without discretionary power, to utilize the entire proceeds of such sales in "earmarking" gold.

2. That the use of notes should be encouraged by all legitimate means, that the number of places for encashment of notes should be increased and that 500 rupee-notes should be universalised at once.

3. That the gold in the Paper Currency Reserve should be used in normal times to supply gold for internal purposes up to the full extent of the resources of the metallic portion of the Reserve. But when exchange would fall to 1s. 3 $\frac{2}{3}$ d., any gold in the Paper Currency Reserve should be given only on such conditions as would secure its immediate export to foreign countries to meet trade requirements.

The Commission also recommended that the gold in the Paper Currency Reserve with its sterling securities would serve as a final source for securing the convertibility of the notes in an internal crisis in India. Any sum over £5,000,000 in the Paper Currency Reserve should be temporary only and used for the purchase of silver for rupee coinage. The Secretary of State for India should not hold ordinarily more than £ 5,000,000 in gold in the London Branch of the Paper Currency Reserve; this gold along with the securities should be used as a second line o

defence in case the exchange showed any sign of weakness. This was a departure from the original purpose of the reserve. The justification for a reserve for the paper currency was in its ability to enable the Government to encash the notes in case they were presented to them.

Before the Government had time to put these recommendations into practice by incorporating them in an Act of the Legislature, war broke out and Government postponed action on the report until the return of normal times.

Paper Currency in War-time. The War put to severe test the Indian Paper Currency which, being unable to bear its heavy strain, threatened to break down. The Government were also compelled to introduce many changes in the Paper Currency to enable them to meet the extraordinary requirements of a prolonged and wearisome War. As we have learnt in a previous chapter, immediately on the outbreak of the War there was a heavy run on Currency Offices for the encashment of notes. The Government took prompt steps to meet all possible demands for the encashment of notes and were soon able to restore confidence of the people in its stability. The run was, however, of a short duration and, as soon as confidence was restored, the circulation of the notes steadily began to increase, so much so that it rose from 49 crores and 97 lakhs in 1914, to 133,58 lakhs of rupees on the 31 March, 1919. This is the first noticeable feature of this period. The table below will show this steady rise :—

Active note-circulation on the 31st March.

1914—Rs. 49, 97 lakhs.

1915— „ 43, 96 „

1916—	„	53, 19	lakhs
1917—	„	97, 08	„
1918—	„	84, 30	„
1919—	„	1,33, 58	„

By active note-circulation is meant all the notes issued by the Government except those held in the Reserve and other Government treasuries and in the Head Offices of the Presidency Banks. This enormous note-circulation was facilitated by the issue of one and two and a half rupee-notes which were introduced in December 1917 and January 1918 respectively. These small notes, particularly the one-rupee notes, became very popular as will be clear from the fact that the value of one-rupee notes in circulation rose from 33 lakhs of rupees on 31 March, 1918, to 10 crores and 51 lakhs of rupees on march 31, 1919. The issue of these notes ceased from 1st January, 1926.

The second point to note is that this large issue of notes was made possible by the successive increase of the invested portion of the Paper Currency Reserve by several acts of the legislature. The nature of this increase is shown in the table below :—

(In crores of rupees)

Acts.	Nature and value of securities which might form this reserve.		
	Permanent investment	Permissible temporary investment (mainly British Treasury Bills)	Total
Act VII of 1911	14	...	14
Act V Temporary amendment, of 1915	14	6	20
Act IX temporary amendment, of 1916	14	12	26
Act XI temporary amendment, of 1917	14	36	50
Act XIX temporary amendment, of 1911	14	48	62
Act VI temporary amendment, of 1918	14	72	86
Act II.....of 1919	14	86	100

Not only the fiduciary portion was increased from 14 crores in 1914 to 100 crores in 1919 of which, as the table above shows, 86 crores were invested in British Treasury Bills but the metallic portion of the Reserve declined heavily as is shown by the table below:—

(IN LAKHS OF RUPEES)

Composition of the Reserve.

Years.	Total circulation.	Silver India.	Gold India & England.	Securities.		
				India	Eng-land.	Total
1915	61.63	32.34	15.29	10.00	4.00	14.00
1916	67.73	23.57	24.16	10.00	10.00	20.00
1917	86.37	19.21	18.67	10.00	38.49	48.49
1918	79.79	10.79	27.52	10.00	51.48	61.48
1919	153.46	37.39	17.49	16.08	82.50	99.58

The table above shows several things. Firstly it shows that the total circulation increased from 61,63 lakhs in 1915 to 153,46 lakhs in 1919, an increase of 132 per cent., and the invested portion rose from 14 lakhs to 99,58 lakhs—an increase of more than 600 per cent. Secondly the silver portion of the Reserve was 35 per cent. of the gross circulation in March, 1916; it was 22 per cent. in 1917, 11 percent in 1918 and 21 in 1919. This fact is worth remembering: a low silver reserve at any time may spell disaster and bring about at least a partial breakdown of the Paper Currency in India as it did in 1918.

The Government, however, had reasons for increasing the fiduciary portion to such an extent. The first reason was that, owing to shortage of silver import into India during the War and the difficulty of purchasing it from abroad, the Government were unable to

coin rupees in a sufficient quantity to meet the growing demands of trade. Mr. Findlay Shirras calculates, that in the five years from 1909-10 to 1913-1914 the excess of merchandise exports over the imports was about £262,000,000 sterling. This balance of trade was liquidated by net imports of funds in the shape of Council drafts, etc., to the extent of £142,000,000 and by the imports of treasures to the extent of £120,000,000. During the first five years of the War, from 1913-14 to 1918-19, this favourable balance amounted to £254,000,000 and was liquidated by net imports of funds to the value of £100,000,000 and by the exceedingly low imports of treasures, of £30,000,000. Coming to annual figures we find that in 1916-17 the net import of treasures was £1,357,000; and in 1918-19 it decreased to the beggarly value of £53,000. Further there was an abnormally high absorption of silver and gold coins by the people who, being unable to get any import owing to the restrictions put on foreign trade by war conditions, did not part with the money they received as exporters. Rupees, for this reason, remained up-country and did not flow back to the ports to replenish the rupee stocks. Lastly large disbursements had also to be made by the Indian Government on behalf of the War Office and called forth heavy coinage of rupees to enable the Government to make these disbursements*.

This shortage of treasures and absorption of rupees and smaller coins brought about a crisis in the history of the Paper Currency in India in 1918 and threatened the convertibility of the notes. This is the third fact worth noting. On March 31, 1918, the rupee balance in the Paper Currency Reserve fell to 10½ crores of rupees, and it became almost certain that the Government would be compelled to declare the notes to be

* See Chapter IX, pp. 133 - 137.

inconvertible. But this situation, the seriousness of which could hardly be under-rated, was saved by the announcement of the purchase of 200 millions of fine silver from America under the Pittman Act (April 23, 1918). This Act was passed mainly to assist foreign Governments at war with the enemies of the United States of America and authorized the Secretary of the Treasury to melt or break up and to sell as bullion, not in excess of 350 million standard silver dollars. To avoid the possibility of making the notes inconvertible, the Government prohibited the sending of specie by rail and steamer and put certain restrictions on the encashment of notes*. These restrictions made people nervous about the power of the Government to maintain the convertibility of the notes which consequently went to a discount in many parts of India.

Babington Smith Committee, 1919. Immediately the War came to an end, the Babington Smith Committee was appointed to go into the whole question of Indian Currency. The Committee submitted its report on December 22, 1919 and made the following recommendations to improve the paper currency of India.

1. That the statutory minimum for the metallic portion of the Paper Currency Reserve should be 40 per cent of the gross circulation. As regards the composition of the fiduciary portion of the Reserve, the securities of the Government of India should not exceed 20 crores and the balance should be held in the securities of other Governments within the British Empire, and of the amount so held not more than ten crores should have more than one year's maturity. The balance of the invested portion, over and above these 30 crores, should be held in short-dated securities, with not more than one year's maturity. The Committee finally

* See Chapter, IX. pp. 139-140.

opined that the existing permissible maximum of the fiduciary portion of 120 crores should be retained for a limited period.

2. That with a view to meeting the seasonal demand for additional currency, provision should be made for the issue of notes up to 5 crores over and above the normal fiduciary issue as loans to the Presidency Banks on the security of export bills of exchange.

3. That the silver and gold in the Paper Currency Reserve should be held in India except for transitory purposes.

4. That as soon as circumstances would permit, free facilities for the encashment of the notes should be given and restrictions imposed during the war should be withdrawn.

From the nature of the first two recommendations it is clear that the object which the Committee had in view was to remove the serious defect from which the paper currency in India had from its very inception suffered, *viz.*, its inelasticity. The recommendations of the Committee were intended to make the paper currency as elastic as possible, even to the point of danger. In the beginning it was the fiduciary portion which was limited and fixed; but now the metallic portion was limited and the fiduciary portion became unlimited. The English Paper Currency still sticks to its old principle of having a limited fiduciary portion. The Babington Smith Committee held that according to the recommendations of the Chamberlain Commission the metallic portion of the reserve, at the time of the report, should have amounted to 119 crores as compared with 80 crores, actually held in the reserve at the time. In the opinion of the Committee such a large metallic reserve was not required for the encashment of the notes. These recommendations called forth, as we have seen, a vigorous

and bitter attack from Mr. Dalal who submitted a note of dissent, differing materially from his colleagues.

The recommendations of the Committee, with regard to the composition of the various forms of investment, were very carefully thought out and intended to meet an emergency of the nature with which the Great European War has made us familiar. In the time of war, which generally creates uneasiness in the minds of people and dislocates business and destroys the confidence of the people in the value of securities, long-dated securities fail to sell. The rupee securities are particularly liable to this danger. When there is a loss of confidence in the value of the notes and a heavy run on the Paper Currency Reserve for their encashment, rupee securities can hardly be sold and will thus fail to help the Government in maintaining the convertibility of the notes.

The second recommendation, as is evident from its nature, was made to meet the seasonal demand for currency. The only mode in which currency could be increased in pre-war days was to issue coins or notes against the tender of gold either in India or in England. Both these processes were expensive, as in either case funds had to be imported from abroad. There was no method to increase the currency internally to meet the seasonal demand, and the rate of discount rose very high during the busy season. To remedy this evil it was suggested that provision should be made to increase the currency by discounting Commercial Bills out of the funds held in the Reserve.

These recommendations of the Committee were incorporated at first in the Paper Currency Act of 1920, and finally in the Consolidating Act of 1923. The Act fixed the metallic portion of the reserve at 50 per cent of the gross note circulation, instead of at 40 per cent

as recommended by the Committee. The Government believed that 40 per cent was too small in a country like India, where more than 90 per cent of the people were ignorant and where people preferred rupees to notes in paying the small traders and moving the crops. The Act also incorporated the recommendations with regard to the composition of the investment. Further the Governor-General was empowered to issue notes up to an amount of 5 crores in value against bills of exchange maturing within 90 days from the date of issue. These notes were to be issued not against bills of exchange, as recommended by the Babington Smith Committee, but against internal bills or hundis drawn for trade purposes. This loan was to be given to the Imperial Bank to help the money market in the busy season, and the rate of interest was fixed at rupees 8 per cent per annum. In passing, we should note that in 1923-24 it was found that the provision for the expansion of currency to meet the seasonal demand fell short of its purpose and was consequently amended in 1923-24 raising the maximum limit from 5 to 12 crores. It was provided that loans should be given as soon as the bank rate would rise to 6 per cent and that the entire amount of the loan outstanding at any time should bear interest at the current bank rate subject to the following minimum rates:— 6 per cent for the first 4 crores, 7 per cent for the second 4 crores, and 8 per cent for the last four crores. These measures again proved insufficient and had to be changed. In 1924 the Government of India announced that a loan of 4 crores should be made to the Imperial Bank when the Bank rate was 6 per cent and 8 crores when the Bank rate would rise to 7 per cent. Lastly, in accordance with the recommendations of the Committee, gold bullion and sterling security at the Paper Currency Reserve were re-valued at the rate of Rs 10 per sovereign. As it was anticipated

from the beginning that these permanent provisions about the limit and composition of the Paper Currency Reserve could not be given effect to immediately, temporary provisions were made for regulating the limit and composition of the Reserve. According to these temporary provisions, the invested portion was fixed at 85 crores instead of at 120 crores without any restriction to the amount of Indian securities and that so long as the 'created securities' of the Government were to exceed 12 crores of rupees, all interest derived from the securities in the Paper Currency Reserve was to be applied from April 1, 1921, to the reduction of such excess holdings. In 1925 the Paper Currency Act was amended and the permissible maximum limit of the securities was raised from 85 crores to 100 crores of rupees, provided the total amount of created securities of the Government of India should not exceed 50 crores.

The permanent provisions of the Acts of 1920 & 1923 concerning the constitution of the invested portion of the Paper Currency Reserve could not be put into practice owing mainly to the financial difficulties of the Government of India.

Functions of the Paper Currency Reserve. Till the year 1898 the Paper Currency Reserve was located in India. Till the year 1893 notes were issued only against silver. In 1893 an Act, Act III of that year, empowered the Government to issue notes against gold. No gold, however, was held under this Act till 1897. In 1898 the Gold Notes Act authorised the Government to issue notes against gold deposited in London. In 1905 by virtue of an Act (Act III of 1905) a branch of the Paper Currency Reserve was created in London. Since that year the Reserve has been kept partly in India and partly in London.

The main function of the Reserve is to secure

the convertibility of the notes. A certain part of the Reserve for this purpose is always kept in coins and bullion, both silver and gold. The rest is kept in securities partly in England and partly in India. But it has developed two other functions. When the London branch was created in 1905, the obvious intention was to keep gold ready for the purchase of silver for coinage in India. This is still one of its functions. Its third function is, and this is perhaps its most important function, to serve as a second line of defence for strengthening exchange. In times of exchange crisis not only gold from the Paper Currency Reserve in India is made available for remittance to London but the securities of the London Branch are sold off to pay for the Reserve Bills sold in India.

Composition of Reserve and circulation of Paper Currency. The following table shows the composition of the Reserve since 1920:—

Year on the 31st March	Gross circulation	Active circulation	Reserve						
			Coin & Bullion.				Internal bills of exchange held in account of the Government of India	Securities	
			Silver coin in India	Gold coin in India	Silver bullion under-coinage in India	Gold coin & bullion in transit		In India	In England
1920	174.52	153.78	32.22	44.37	6.63	3.45	...	10.50	67.27
1921	166.16	147.88	61.42	24.17	...	...	...	68.07	8.34
1922	174.76	157.23	72.96	24.32	...	...	...	65.08	5.85
1923	174.70	161.10	82.50	24.32	...	...	...	57.48	5.85
1924	185.85	169.66	74.18	22.32	...	...	12.00	57.53	1.40
1925	184.19	166.55	70.02	22.32	...	...	...	57.12	19.96
1926	193.34	167.71	77.25	22.32	...	...	8.00	57.11	29.00
1927	184.13	164.31	95.94	22.32	...	...	...	49.77	5.57
1928	184.87	174.53	98.72	29.76	...	...	2.00	37.96	3.77
1929	188.03	178.19	94.94	32.22	4.95	...	7.00	43.23	10.69
1930	177.28	159.10	108.11	32.27	2.85	...	2.00	33.85	15

Hilton Young Commission, 1925. The entire position of the Currency System, outlined above, was carefully reviewed by a Royal Commission in 1925 which recommended a thorough overhauling of the system. With a view to place it on a new and more satisfactory basis the Commission recommended that the Government should cease to be a note-issuing authority, that in future notes of all denominations should be issued by a New Bank, the Reserve Bank, to be run on the lines of the Central Bank of other countries, and that the fiduciary portion should henceforth bear a proportional ratio to the reserve, the object being to make the note-issue more elastic. The notes and the rupees were to be convertible henceforth into gold bars of not less than 400 ounces. The Commission deprecated a system according to which one form of notes printed on paper was converted into another form of notes, printed on silver. Their recommendation was intended to put a stop to the difficulties that often arose owing to the fluctuations in the price of silver. The Reserve Bank was required to ensure the convertibility of the notes and the rupees, to keep in its reserve gold and gold securities to the extent of not less than 40 per cent of the total note-issue plus 50 crores of rupees on account of outstanding rupees subject to a possible temporary reduction with the consent of the Government on payment of tax. The new notes issued by the Bank could not be converted into silver rupees but into notes of smaller denominations or into silver rupees *at its option*. The Commission also recommended that the Currency authority should reintroduce one rupee note which should be legal tender and should not be convertible into rupees.

We will discuss all these recommendations of the Commission in detail in Chapter XIV and the steps taken by the Government of India to give effect to them.

Chapter XII

POST-WAR PERIOD 1920-27

New Policy

The Government accepted the recommendations of the Babington Smith Committee, and modified the Currency System accordingly, embodying them into various notifications which were issued in February 1920.

1. In the first place the Government declared that they would sell weekly Council Drafts and Telegraphic Transfers at competitive prices with a minimum rate varying with the cost in sterling of shipping gold to London as long as sterling would differ from gold in price. Similarly they were to sell Reserve Drafts in India on London whenever exchange would show any tendency to fall below the Official price of the rupee which was fixed at 11·30016 grains of fine gold as measured by the prevailing sterling-dollar exchange; i. e., the price of the rupee was fixed at 2s. gold.

2. By the Coinage Amendment Act, Act XXXVI of 1920, the Government restored the legal tender character of the British sovereign and half-sovereign (their legal tender character was suspended by an Ordinance No. III of 1920) and fixed their prices at Rs 10 and Rs 5. The Government declared that they would receive sovereigns and half-sovereigns at the rates mentioned above, but would not issue any gold coin. It may be mentioned here that as the market price of sovereign was higher than Rs 10, it was never offered to the Government Treasury.

3. Finally the prohibition of the import of silver and duty on its imports were withdrawn and gold and silver coins were allowed to be freely melted and exported.

Of these declarations the most important was the one which changed the gold value of the rupee. At that time we should remember America was the only country (except Japan) which had a free gold market, and where the standard coin was at par with gold. The gold standard having been abandoned, the English sterling had lost its gold parity and had depreciated in its value in terms of dollar, which was a gold coin. If sterling were to fall in terms of gold, more sterling would be required to buy a given quantity of dollar, or which is the same thing, a given quantity of gold would fetch more sterling. Thus before the War one £ sterling was equal to 4·86 dollars; this was the mint par between £ sterling and gold dollar. On the 2nd February, 1920, the sterling-dollar rate fell to 3·65. This means that one pound sterling which was in pre-war days equivalent to 4·86 dollars, was equivalent in February, 1920, to 3·65 dollars. Before the War one pound sterling used to fetch 4·86 dollars; in February, 1920, more sterling was necessary to fetch the same number of dollars. If the price of sterling was to fall in terms of gold, one gold sovereign which was equivalent to Rs 10, would fetch more shillings to the rupee. In other words the price of the rupee would rise in sterling; *i. e.* one rupee would bring more shillings. If the sterling-dollar exchange falls, the sterling-rupee exchange would rise.

Breakdown of the System

From the beginning it was apparent that there was little chance for the Government to maintain successfully the new ratio. The market price of the rupee was higher than 2s. gold at the time of the

issue of the notifications, and there was absolutely no necessity for the Government to sell Reverse Bills. But the Government refused to read the indications of the time and started selling Reverse bills which aggravated the situation, encouraged speculation and sent up the price of the rupee. On the date of the publication of the report of the Babington Smith Committee the sterling-dollar exchange fell to \$3.65. This fall in the price of sterling in terms of gold—dollar was a gold coin—meant a rise in the sterling price of the rupee, fixed at 2s. gold. Fearing that there might be a further rise in the sterling price of the rupee, Indian merchants made a heavy rush to sell their bills of exchange as at a higher rate they were to get fewer rupees. But this rush of the exporters to cash their bills in rupees had the unexpected result of raising the sterling value of the rupee to 2s. 8½d.; and this happened immediately after the announcement of the new ratio. Shortly after this the sterling again fell in terms of dollar (gold), and this fall in turn sent up the price of the rupee to 2s. 10½d. (sterling) in February, 1920.

Another noticeable factor was that, as the rate of exchange rose, the Indian importers, taking advantage of the favourable situation, made a heavy demand for Reverse Council bills to remit money to England. It was very cheap to remit money when the exchange was high; a smaller amount of rupees, say less than Rs. 10, would buy articles worth one pound sterling. Foreign businessmen and firms in India, for the same reason, found it profitable to remit their profits to England. On top of this came an orgy of speculation indulged in by many merchants who began to send money to London with the avowed object of bringing it back to India when the exchange would fall in the hope of making profits. A further

rise in exchange meant that less than 10 rupees would fetch one sterling pound; a fall meant that more than Rs. 10 could be obtained in exchange for one sterling pound. This difference was the gain which a speculator hoped to reap. An unsteady exchange always encourages speculation of this nature. The demand for Reverse Bills was so great that there arose a sharp difference between the Reverse Council rates and the market rates.

But soon a change came over, and the exchange began to fall. The balance of trade began to turn against India, and consequently the price of the rupee began to fall. This turn in the balance of trade became evident as early as January, 1920. The Government at once began to sell reverse drafts at 2s. 8d. sterling under the mistaken belief that the balance would turn soon in favour of India. But there was no such indication; the balance, instead of turning in favour of India, moved directly against her. This unfavourable balance pulled down the price of the rupee to below 2s. sterling; it stood at 2s. 1¼d. on the 1st June, 1920 and fell to 1s. 8¼d. by the end of that month; in September of the same year it stood at 1s. 10d.

A variety of causes brought about this unfortunate result. Imports increased, in the first place, owing to an increased demand for foreign goods, particularly piece-goods and, in the second place, to the stimulus given by a high exchange. The increase of import was accompanied by a decrease of export caused by the loss of some of her best markets by India. Japan, an important market for Indian cotton, failed to purchase her usual amount owing to an internal financial crisis. Central Europe, which used to buy a fairly large amount of Indian goods, stopped their purchases

for want of purchasing power, brought about political and economic troubles caused by the world war. There was a heavy depreciation in the purchasing power of these states. Lastly demand for Indian jute, tea and hides which usually accounted for a fairly large portion of our excess of exports over imports fell off, partly owing to the accumulation of large stocks of these articles in England and partly to the general uncertainty prevalent at the time in the international market. The table below shows the extent of the unfavourable balance month by month from April 1920 to March 1921.

(In crores of rupees)

Months.	Imports.	Exports.	Excess of exports (+) Excess of imports (-)
April, 1920	22	28	+ 6
May, "	24	28	+ 4
June, "	26	23	3
July, "	28	21	- 7
August, "	31	20	- 11
September, "	29	21	8
October, "	32	21	- 11
November, "	32	19	- 13

(In crores of rupees.)

Months	Imports	Exports	Excess of exports(+)
			Excess of imports(-)
December, 1920	32	20	- 12
1921			
January	31	19	- 12
February	25	18	- 7
March	24	18	- 6

The Government made serious efforts in various directions to pull up the exchange. Besides the weekly sale of Reverse Drafts the Government sold considerable quantities of gold every fortnight; such sales, it was believed, would lower the price of gold in terms of silver by increasing the supply of gold. Though gold worth 53 millions was sold, the price of the rupee did not arise at all. The Government also contracted currency, as noted below, to raise the price-level in India with a view to turn the direction of trade. This contraction was effected by the withdrawal of a part of the currency with which the Reverse Bills were purchased. The Reverse Council Drafts were paid for in England by the proceeds of the sale of the securities held in the Paper Currency Reserve; the money in the Treasury Balance was too inadequate to pay for the Bills. This sale of the securities reduced the fiduciary portion of the Paper Currency Reserve and called for a corresponding reduction in the note-issue. Thus the gross note-issue which stood at a little over 183 crores in January 1920 was

reduced to 158 crores in September of that year.

These attempts of the Government to strengthen exchange and reverse the course of trade could not succeed. But the Government persisted in their policy and continued to sell the Reverse drafts till September 1920, when they gave up in utter despair all attempts to regulate the exchange. At first they sold the Reverse Drafts at 2s. gold per rupee; but when they found that they were unable to stop the fall in exchange, they began to sell Telegraphic Transfers at 1s. 11½d. But the exchange continued to fall and the Government had to follow the market price in fixing the rate of the Reverse Drafts.

This automatic expansion and contraction of the Currency was supposed to be the greatest merit of the pre-war Indian exchange system. Later on, in 1925, it was, however, pointed out by the Hilton Young Commission that the greatest defect of the pre-war Indian Currency system was the absence of this quality. In the opinion of Sir E. Hilton Young and his colleagues, the Indian Currency was never expanded to the full amount of the sales of Council Bills, nor contracted to the full extent of the Reverse Council Bills sold. These desperate efforts to arrest the fall of exchange failed and the Government had to give up the attempt to regulate it. Thus the exchange standard broke down hopelessly. From January to September 1920 the Government sold Reverse Council Bills worth £55,382,000. These bills were paid out from the proceeds of the sale of sterling securities and Treasury Bills of the Paper Currency Reserve and Gold Standard Reserve in London. These securities were purchased at the rate of Rs 15 per pound; but they were sold at Rs 7 to Rs 10 per pound, resulting in a loss of Rs 8 to Rs 5 per pound. In all the total loss amounted to about 35 crores of rupees.

This adverse balance to the utter despair of the Government, continued throughout the whole of 1920-21 and 1921-22. The total visible balance against India in 1920-21 was 50 crores and 14 lakhs of rupees, and in 1921-22 it was 33 crores and 73 lakhs.

Causes of the break-down. This break-down of the exchange standard, supposed to be one of the best standards in the world, was, in the circumstances explained above, inevitable. The only justification for the Government to persist in a policy which it was evident from the very beginning would break down was that they had the support of an expert committee. Further it should be remembered that the policy was not fully tried. The sale of Reverse Bills influences the exchange in two ways. In the first place, the amount of these bills sold in India and paid out of the reserves in England was the equivalent of an increase in exports and this tended to strengthen, if not to maintain, exchange. Secondly, the Government withdrew the proceeds of the sales of the bills (they are purchased with rupees) from circulation and contracted currency. This tended to increase exports by lowering prices and to diminish imports.* Thus a contraction of currency rights a weak exchange. But the Government of India, though they sold freely the Reverse Bills, did not, rather could not, contract currency to the full extent of the value of these bills; they continued issuing new currency along with the sale of the Reverse Bills. Such an action could have no influence on price-level which remained as high as before and thus failed to bring about the desired result. Finally the Babington Smith Committee blundered miserably in concluding that the cause of the rise in

* See Chapter IV, page 62 and Chapter VI, page 93; also Findlay Shirras, *Indian Finance and Banking*, page 36.

the price of the rupee was due exclusively to a rise in the price of silver. What the Committee would have done well to bear in mind was that the rise in price of the rupee was due to a rise in the sterling prices of commodities as compared to the rise in their rupee prices.

The course of trade, we have seen, turned heavily against India in 1920, and this adverse balance partly accounted for the fall in exchange; partly it was accounted for by the heavier fall in the price-level in England and U. S. A. than in India.

Months.	Price Index Numbers.			Rate of Exchange from Calcutta on London on the first of every month.	
	Great Britain (1913) parity.	U. S. A. (1913) parity)	India (July 1914 parity)		
				Sterling	Gold
1920				s. d.	s. d.
January	289	233	204 (annual average.)	2 3 $\frac{7}{8}$	1 10
February	303	232		2 8 $\frac{1}{2}$	1 11 $\frac{7}{32}$
March	310	234		2 7	1 9 $\frac{23}{32}$
April	306	245		2 4	1 10 $\frac{1}{4}$
May	305	247		2 3 $\frac{1}{4}$	1 9 $\frac{7}{16}$
June	291	243		2 1 $\frac{1}{4}$	1 8 $\frac{3}{8}$
July	293	241		1 8 $\frac{3}{4}$	1 4 $\frac{7}{8}$

Months.	Price Index Numbers.			Rate of Exchange from Calcutta on London on the first of every month.		
	Great Britain (1913 parity).	U. S. A. (1913 parity).	India (July 1914 parity)	Sterling.	Gold	
August	288	231	} 204 (Annual average.)	1 10 $\frac{5}{8}$	1 5 $\frac{5}{16}$	
September	284	226		1 10 $\frac{1}{4}$	1 4 $\frac{5}{16}$	
October	266	211		1 9 $\frac{3}{8}$	1 3 $\frac{17}{32}$	
November	246	196		1 7 $\frac{3}{8}$	1 1 $\frac{11}{16}$	
December	220	179		1 6 $\frac{3}{8}$	1 1 $\frac{3}{16}$	
1921						
January	209	170		1 5 $\frac{1}{4}$	1 0 $\frac{15}{32}$	
February	192	160		181	1 4 $\frac{1}{4}$	1 1 $\frac{1}{8}$
March	189	155		} Annual average.)	1 3 $\frac{3}{8}$	1 0 $\frac{3}{8}$
April	183	148			1 3 $\frac{5}{8}$	1 0 $\frac{23}{32}$
May	182	145		1 3 $\frac{21}{32}$	1 0 $\frac{23}{32}$	
June	179	142		1 3 $\frac{1}{4}$	1 1 $\frac{1}{4}$	

Months.	Price Index Numbers.			Rate of Exchange from Calcutta on London on the first of every month.	
	Great Britain (1913 parity).	U. S. A. (1913 parity).	India (July 1914 parity)		
				Sterling	Gold
July	178	141	181	1 3 $\frac{5}{16}$	0 11 $\frac{23}{32}$
August	179	142	(An-	1 3 $\frac{13}{32}$	0 11 $\frac{9}{23}$
September	183	141	nual	1 4 $\frac{11}{16}$	1 0 $\frac{13}{16}$
October	170	142	aver-	1 5 $\frac{3}{8}$	1 1 $\frac{3}{8}$
November	166	141	age)	1 4 $\frac{1}{2}$	1 1 $\frac{5}{16}$
December	162	140		1 3 $\frac{7}{8}$	1 1 $\frac{5}{32}$

In looking down the table we find that the gold value of the rupee was at its highest in February, 1920. The price-level in Great Britain and the United States was also rising in that period and was much higher than the Indian price-level. From June of that year prices began to decline and went on declining both in Great Britain and U. S. A; but there was no corresponding fall in the Indian price-level. This relatively high Indian price-level meant the low purchasing power of the rupee and accounted for the steady fall in its gold and sterl-

Note.—British figures have been taken from the Economist, the American figures from U. S. A. Bureau of Labour and the Indian figure, from the Indian Trade Journal.

ling value. The 2s. gold value of the rupee could possibly be maintained so long as its purchasing power was equal to its gold parity. This price of the rupee was fixed at a time when prices were abnormally high and when it was equivalent to 2s. gold. The downward tendency of the gold value of the rupee continued till August 1921 when it fell to below 1s. 4d. sterling which was equivalent to less than 1s. gold. This happened inspite of the fact that the Government contracted in 1920-1921 currency to the extent of 31 crores and 51 lakhs.

Effects of the Break-down. It would be interesting to note the effects of this breakdown on the Indian exchequer and business community. It is enough to remember that the Indian exchequer, as stated already, lost to the tune of 35 crores of rupees. But the loss to the Indian business community was equally severe. Indian importers ordered goods from foreign markets at a time when the Government declared their intention to maintain exchange at 2s. gold. When the goods reached India, the importers, to their utter dismay, found that the exchange had fallen, and the Government had withdrawn from the exchange market. With the rupee at 2s. gold an article worth one £ would cost only Rs. 10; but with a fall in the price of the rupee the same article would cost more than Rs. 10. This was exactly what happened in 1921. When the articles ordered reached India, the price of the rupee had fallen and for one £ the importers had to pay more than Rs. 10. The importers incurred heavy losses and the exporters also would not sell their articles. Lastly deflation of currency spelled ruin in the business community. The contraction of currency, in the first place, made the money market tight and raised the bank rate on loanable money; in the second place it tended

to lower the price-level and hit businessmen hard; they could not get money to carry on trade and had to sell their merchandise at prices much lower than the expenses of production. In the language of Sir Stanley Reed it was a "policy which, though avowedly adopted to secure fixity of exchange, produced the greatest fluctuations in the exchanges of any solvent country and widespread disturbance of trade, heavy losses to the Government and brought hundreds of big traders to the verge of bankruptcy *".

Revival of Trade, 1923—27.

Trade however showed signs of revival in February, 1922. There were a favourable monsoon and a good harvest in India. The purchasing power of some of the European countries, which had fallen very low in the previous year, revived very appreciably. This was due to the return of normal political conditions in these countries. Great Britain and America slowly acquired their former position and started purchasing Indian articles, if not in their usual quantities, at least in quantities larger in amount than in the two preceding years. Concurrently with this rise in exports, India's imports of foreign articles declined and from February, 1922, balance of trade began to turn slowly in India's favour as is shown below:—

*India Year Book, 1925 page, 244.

(In crores of rupees.)

Year.	Exports and imports of merchandise on private account.		Excess of exports.	Net imports of treasures
	Exports.	Imports.		
1920-21	258	335	-77	1
1921-22	245	266	-21	12
1922-23	314	224	+90	59
1923-24	362	217	+145	47
1924-25	398	243	+155	94
1925-26	375	226	+149	62
1926-27	309	229	+79	39

This turn in the balance of trade in favour of India was accompanied by a rise in the price-level in England and America, as is shown in the table below at page 204; it also pulled up the price of the rupee to 1s. 4d. sterling in January 1923. The Government also to strengthen exchange stopped the sale of Council Drafts in London and thus prevented the circulation of additional rupees which would have been necessary for the encashment of these Bills. This new circulation would have raised prices in India and weakened exchange. Further the currency was deflated with a view to keep down the prices to a low level. The method adopted in deflating the currency was the sale of the Indian securities in the Paper

Currency Reserve and a corresponding cancellation of the note-issue.

Price Index Number and the Rate of Exchange.

Year.	Price Index Number.			Rate of Exchange	
	Great Britain (1913 parity.)	U.S.A. (1913 parity.)	India (July 1914 parity.)	Sterling.	Gold.
				s. d.	s. d.
1922					
January	159	159	178	1 3 $\frac{5}{16}$	1 1 $\frac{25}{32}$
February	158	141	179	1 3 $\frac{5}{8}$	1 1 $\frac{28}{32}$
March	160	142	182	1 3 $\frac{3}{16}$	1 1 $\frac{27}{32}$
April	159	143	182	1 3 $\frac{3}{16}$	1 1 $\frac{21}{32}$
May	162	148	187	1 3 $\frac{15}{32}$	1 1 $\frac{25}{32}$
June	163	150	183	1 3 $\frac{21}{36}$	1 2 $\frac{3}{8}$
July	163	155	181	1 3 $\frac{5}{8}$	1 2 $\frac{3}{16}$
August	158	155	178	1 3 $\frac{21}{32}$	1 2 $\frac{5}{16}$
September	156	153	176	1 3 $\frac{17}{32}$	1 2 $\frac{7}{32}$
October	158	154	177	1 3 $\frac{9}{16}$	1 2 $\frac{7}{32}$
November	159	156	178	1 3 $\frac{21}{32}$	1 2 $\frac{11}{32}$

Price Index Number. Rate of Exchange.

Years.	Great Britain (1913 parity.)	U.S.A. (1913 parity.)	India (July 1914 parity.)	Sterling.		Gold.	
				s.	d.	s.	d.
Dec.	158	156	176	1	3 $\frac{31}{32}$	1	2 $\frac{7}{32}$
1923 January	160	156	179	1	4 $\frac{1}{32}$	1	3 $\frac{9}{32}$
February	163	157	180	1	4 $\frac{5}{16}$	1	3 $\frac{5}{8}$
March	163	159	181	1	4 $\frac{5}{16}$	1	3 $\frac{5}{8}$
April	165	159	178	1	4 $\frac{1}{16}$	1	3 $\frac{13}{32}$
May	164	156	177	1	4 $\frac{1}{16}$	1	3 $\frac{7}{16}$
June	160	153	175	1	4 $\frac{1}{16}$	1	3 $\frac{5}{16}$
July	155	151	170	1	4 $\frac{3}{32}$	1	3 $\frac{1}{8}$
August	155	150	171	1	4 $\frac{1}{32}$	1	3 $\frac{1}{16}$
September	160	154	174	1	4 $\frac{1}{32}$	1	3
October	160	153	174	1	4 $\frac{5}{32}$	1	3 $\frac{3}{32}$
November	169	152	177	1	4 $\frac{11}{16}$	1	3 $\frac{3}{8}$

Years.	Price Index Number.			Rate of Exchange from Calcutta on London on the first of every month.			
	Great Britain (1913 parity.)	U. S. A. (1913 parity.)	India (July 1914 parity)	Sterling		Gold.	
				s.	d.	s.	d.
December 1924	170	151	179	1	5 $\frac{7}{32}$	1	3 $\frac{3}{8}$
January				1	5 $\frac{3}{32}$	1	3 $\frac{1}{16}$
October				1	5 $\frac{23}{32}$	1	4 $\frac{1}{4}$
December 1925				1	6 $\frac{1}{32}$	1	5 $\frac{3}{16}$
January				1	6 $\frac{1}{16}$	1	5 $\frac{21}{32}$
April				1	5 $\frac{27}{32}$	1	5 $\frac{27}{32}$
December 1926				1	6 $\frac{5}{32}$		Do.
January				1	6 $\frac{5}{32}$		Do.
April				1	5 $\frac{7}{8}$		Do.
December				1	5 $\frac{3}{4}$		Do.

Sterling reached gold parity

These methods, as stated above, slowly brought about a rise in the price of the rupee which, as the table shows, stood at 1s. 5 $\frac{7}{32}$ d. sterling and 1s. 3 $\frac{3}{8}$ d. gold in December, 1923.

This progress was maintained in 1924-25. Owing to timely rain all over the country there were a good harvest and a large amount of surplus of agricultural products for exports; the imports, on the other hand, decreased mainly on account of the high prices of the imported commodities. In consequence of these causes the balance of trade in merchandise (See the table at page 203) amounted to 155 crores of rupees: the import of treasury amounted to 94 crores and the visible balance to 61 crores. The price-level between December 1923 and September 1924 was steady both in India and America and a little higher in England; this also helped materially the rupee to maintain its price at a fairly high level. In October 1924 the price of the rupee was 1s. 5 $\frac{3}{8}$ d. sterling which was equivalent to 1s. 4 $\frac{1}{4}$ d. gold, the pre-war parity. From October 1924 to 1926 the price of the rupee showed an upward tendency and was steady at a little below 1s. 6d. gold. This was accounted for by a rise in the sterling prices of commodities in the United States and England and a favourable balance of trade. The Government wanted to keep down a further upward movement in the price of the rupee and began, with that object in view, to offer Council Bills and to purchase sterling in India; both these two processes released more rupees into circulation and thus raised the level of prices in India. In 1924-25 the Government of India remitted £ 33,191,000 to London by the purchase of sterling which had the same effect on the circulation of money and prices as the sale of Council Bills and £7,579,000 by sale of Council Bills; new currency was thus

put into circulation. The note-issue was also expanded, as we have seen already, to 14 crores and the fiduciary portion of the note-issue was raised from, 85 crores to 100 crores in 1925. In spite of this expansion of currency the price fell from 176 in October to 162 in March 1925. This fall in the price-level, in spite of the expansion of currency, points to the conclusion that the volume of trade which this currency had to carry on was very large and the gold value of the rupee rose from 1s. $4\frac{1}{8}$ d. in November and 1s. $5\frac{3}{8}$ d. in December 1924 to 1s. $5\frac{1}{2}$ d. in January and to 1s. $5\frac{1}{2}$ d. in March 1925. In April, 1925, sterling reached its gold parity.

In 1925-26 there was also a fairly large visible balance in favour of India (See the table at page 203); there was also no marked change in the price-level. In these circumstances the Government had to purchase sterling in India to prevent the rise in exchange and were able to keep exchange stable at 1s. 6d.

The exchange during this year never went below the lower gold point. It was not allowed to rise above the upper gold point by Government manipulation and was thus established at 1s. 6d. The balance of trade was favourable in 1926-27, the year of the appointment of a new Royal Commission, known after its Chairman as the Hilton Young Commission. The visible balance of trade dropped in that year to 39.76 crores. But this was not all. The price-level in America fell from 152 in March 1926, to 145.3 in March 1927. Under these circumstances the exchange could only be kept at 1s. 6d. by a heavy contraction of currency. To effect this the Government Purchased much less sterling than in the previous year, sold sterling of the value of £1,435,000 and contracted currency by withdrawing $9\frac{1}{2}$ crores from circulation. Recourse to these methods enabled the

Government to maintain the exchange at or near 1s. 6d. as will be evident from the table below.*

Years.	Highest.	Lowest.
1926		
April	1 $5\frac{29}{32}$	1 $5\frac{25}{32}$
May	1 6	1 $5\frac{27}{32}$
June	1 $5\frac{15}{16}$	1 $5\frac{7}{8}$
July	1 $5\frac{29}{32}$	1 $5\frac{27}{32}$
August	1 6	1 $5\frac{29}{32}$
September	1 $5\frac{31}{32}$	1 $5\frac{15}{16}$
October	1 $5\frac{19}{32}$	1 $5\frac{13}{16}$
November	1 $5\frac{27}{32}$	1 $5\frac{3}{4}$
December	1 $6\frac{1}{32}$	1 $5\frac{31}{32}$
1927		
January	1 $6\frac{1}{32}$	1 $5\frac{31}{32}$
February	1 $5\frac{31}{32}$	1 $5\frac{7}{8}$
March	1 $5\frac{31}{32}$	1 $5\frac{27}{32}$

* From the Reports of the Controller of Currency.

Chapter XIII

HILTON YOUNG COMMISSION, 1925-26.

Appointment of the Commission, 1925.

In 1925, the Government of India requested the Secretary of State for India to appoint a Royal Commission to make a thorough and sifting enquiry into Indian currency and exchange and suggest methods for its improvement. Such a Commission was appointed under the Royal Seal on August 25, 1925, with Sir Edward Hilton Young as its Chairman and nine members, of whom 4 were Indians, namely, Sir Rajendra Nath Mookerjee, Sir M. B. Dadabhoy, Sir Purshotamdas Thakardas and Mr. (now Sir) J. C. Coyajee. The report was published on August 4, 1926. Sir Purshotamdas Thakardas dissented from the majority and wrote a dissentient note. The Commission were asked (1) to examine and report on the Indian currency and exchange system and practice and (2) to consider whether any modifications were desirable in the interests of India. The only point worth noting is that the terms of reference were as wide as possible, wide enough to enable the Commission to traverse the entire ground. The object was to give the Commission a free hand, so that they might find out the defects of a system which, in the stress of unfavourable circumstances, broke down hopelessly.

Defects of the Exchange standard

After making a rapid historical survey of the Indian

currency system, as it developed from 1893 to 1925, the Commission examined the system as it obtained in 1925 and found that, though the system had worked well from 1898 to 1920, it had the following defects :—

1. The first defect which the Commission noticed was that the Indian Currency consisted mainly of two token coins, the silver rupee and the paper note.

2. The second great defect which the Commission pointed out was that, though the value of the rupee was maintained by the Government at or in the neighbourhood of 1s. 6*d.* at that time (in 1925), there was no legal obligation on the part of the Government to do so. The Government as currency authorities were freely purchasing at that time sterling at 1s. 6 $\frac{3}{8}$ *d.* and was selling through the Imperial Bank sterling at 1s. 5 $\frac{1}{4}$ *d.* The object was to maintain the gold value of the rupee at 1s. 6*d.*; but this stability of the gold value of the rupee was not based on anything more substantial than a policy of the Government, a policy which could not be found defined in any notification or legal undertaking of the Government. In other words the Government only chose to maintain this ratio as a policy convenient to them, there was no legal obligation compelling them to do so.

3. The third drawback, in the opinion of the Commission, was the unnecessary duplication of the Reserves. There were two Reserves, the Paper Currency and the Gold Standard Reserves. The Commission pointed out that though these Reserves were originally intended to perform different functions, they were very often utilised for the same purpose. The Paper Currency Reserve, though originally intended to provide for the convertibility of the notes, had often been resorted to, as the readers remember, for maintaining the ex-

change, a function which the Gold Standard Reserve was primarily to perform.

4. Fourthly the Commission pointed out that the principles underlying the Reserves and the manner in which they should be used had not been properly recognised and understood in India. The reserves were created mainly to stabilise the external value of the rupee. Their efficiency to carry this out depended, in the opinion of the Commission, on (1) their adequate size and (2) their use in an effective manner. The Commission held that if the Reserves were to function properly, the following conditions should be fulfilled:— (1) That these Reserves must be large enough, if they were to perform their functions successfully, to enable the authorities to sell sterling to any amount for Indian currency (rupees & notes) whenever exchange would show signs of weakness; (2) that sterling should be sold "promptly and without condition," whenever there would arise any need for such sales and (3) that the Indian currency should always be contracted by the amount of the sale of the sterling. These principles, the Commission found, had never been recognised and acted upon in India. There was no statutory provision to enforce them. In this connection the Commission noticed that there was no provision for regulating the organic relation between the total amount of token currency and the amount of the reserves. With regard to note-issue, they noticed, there was no statute fixing a minimum percentage of gold or sterling securities to be kept in the reserve as a backing against the note-issue. There was also no relation between the rupees in circulation and the reserves either. The amount of the Gold Standard Reserve and the time and manner of its use were wholly within the discretion of the Government. This fact showed

that the use and amount of the Reserve were arbitrary and devoid of any automatic relation between the amount of the Reserve and the currency in circulation.

5. But the most serious defect of the exchange standard, the Commission pointed out for the first time in the long history of the Indian currency, was that the system had never secured an automatic expansion and contraction of the volume of currency. In the language of the Report "the fundamental basis of such a standard is the provision for the expansion and contraction of the volume of currency." As the reserve would increase with a favourable balance of trade, there should be a corresponding expansion of the currency; a fall in the reserve, brought about by an adverse balance of trade, should be accompanied by a corresponding contraction of the currency. The Reserve rises by the proceeds of the sale of Council Bills or by the purchase of sterling; similarly they fall by the sale of Reverse Council Bills or of sterling. This is the fundamental principle underlying an automatic system. In a previous chapter we noticed that Mr. Keynes held, in support of the Indian system, that it had worked automatically, contracting or expanding in accordance with trade requirements. The Royal Commission of 1925, consisting of eminent economists and financial experts, repudiated this view in a clear and unmistakable language and held that, "under the Indian currency system, contraction is not, and never has been automatic". To remit money to London, sterling had often been purchased; but the purchases, the Commission pointed out, were made not against the reserve but against the Treasury Balances, and the expansion of the currency was left at the discretion of the Government. With regard to contraction the Commission found that the sale of the Reverse Council Bills had

seldom been accompanied in the past by a corresponding contraction of the currency as the table below would show:—

Years	Amount of Reverse Bills sold (in lakhs of rupees)	Amount of contraction (in lakhs of rupees)
1907-8-9	12,16	12,16
1909-10	24	Nil
1914-15	13,16	1,05
1915-16	7,38	34
1918-19	7,08	Nil
1919-20-21	47,14	34,68

In the absence of an automatic expansion and contraction of the domestic currency, the exchange standard could not work; so it failed in 1920.

6. Another drawback was that the Indian currency was inelastic and thus lacked the merits of a well-regulated system. In India there had always been a seasonal variation in the demand for money. There had been often a heavy demand for money in the busy season of the year for moving the crops. But the Currency system, the Commission found, could not expand with an expansion of trade. In spite of the provision in the statute that currency notes to the value of 12 crores might be issued against hundis or internal Bills to meet the seasonal variation, there had not been sufficient issue of such notes owing

to the absence of a sufficient number of genuine trade bills. There was also no provision for the expansion of currency in case of an internal financial crisis.

7. Lastly the Commission emphasised the fact, a fact which was pointed out by Mr. Keynes as early as 1913, that there was no co-ordination of control of currency and credit. In India the currency and the note-issue were controlled, as they are even now, by the Government and the credits, by the banks. In the first place such a system had separated the banking from the currency and had failed "to effect their specific purpose of stabilisation in the most economical and efficient manner". Secondly, "with divided control, there is likelihood of divided counsels and failure to co-ordinate". The only method to get rid of this defect, in the opinion of the Commission, was to amalgamate them and invest them in a Central Bank.

The Commission summed up these defects as follows:—

1. The system was far from simple and the basis of the stability of the rupee was not readily intelligible to the uninstructed. One form of token currency (the rupee) was highly expensive and was liable to vanish if the price of silver rose above a certain level.

2. "There is a cumbrous duplication of reserves" with a "division of responsibility for the control of credit and currency policy."

3. "The system does not secure the automatic expansion and contraction of currency. Such movements are too wholly dependent on the will of the currency authority."

4. "The system is inelastic."

The critical analysis of the defects of the exchange standard, given above, pointed to the essential features of a currency that would suit India

best. Though the system had worked well from 1898 to 1913, it was in the opinion of the Commission, neither certain nor simple and had not the confidence of the people. The Commission held the view that without certainty and simplicity in the currency system, people could have no confidence in it, and, without such confidence, the uneconomic habit of hoarding and disinclination to investment could not be corrected.

Of the various methods suggested to remove the defects of the currency system, the following were considered by the Commission :—

1. That the sterling exchange standard should be perfected.

2. That a gold exchange standard should be adopted.

3. That a gold standard with or without a gold currency should be introduced.

Sterling Exchange Standard

It was pointed out that the sterling exchange standard could be perfected and freed from its defects (1) by the amalgamation of the reserves and (2) by placing a statutory obligation on the Government to sell freely in London rupees for sterling at the upper gold point of a fixed parity and sterling for rupees in India at the lower gold point of the same parity. The Commission however were unable to accept the proposal for two reasons. Only one reserve in the place of two and a statutory obligation to sell freely either rupees or sterling according to the requirements of trade would make, the Commission admitted, the system both automatic and elastic. But the system would still have two grave defects. If the price of the silver were to rise again, the system might breakdown as it did in 1919. In the second place if sterling were to be divorced

from gold, the rupee would follow suit. Sterling, divorced from gold, was likely to depreciate in its gold value, and the rupee, being linked to sterling, would also depreciate. Prices, in that case, would rise in India and cause hardship to the people. This rise, however, could be checked by raising the exchange, but a high exchange had its disadvantages also. The Commission, however, thought that there was no possibility in the near future of sterling being divorced from gold. The unexpected has, however, happened; sterling stands to-day (1932) divorced from gold. For these two defects the Commission refused to recommend a sterling exchange standard for India.

Gold Exchange Standard

A gold exchange standard, like the sterling exchange standard, was, in the opinion of the Commission, unsuitable for India. The Commission realised that a gold exchange standard could be made automatic, elastic and stable by the same methods by which the sterling exchange could be perfected, *viz.*, by the amalgamation of the two reserves into one and by making it obligatory on the Government to buy and sell, at the upper and lower gold points respectively, and to an unlimited amount, the currencies of any of the principal countries of the world with a gold standard. Even in this case the value of the rupee might vary in relation to gold if the currencies of these countries ceased to maintain this relation. Such a system, the Commission held, would have decided advantages in comparison with the system then prevailing. Under this system "the internal currency would be convertible into international currency (gold) at the will of the holders and the rupee would thus be stabilised; the reserves would be simplified, and the parity with gold would be established by statute."

In spite of these advantages the Commission rejected the proposal as it would have still certain defects which are inherent in an exchange standard. Of these defects we have noted one already. This is the token character of the rupee. The rupee as a coin would disappear from circulation as soon as the price of silver would rise above its silver content. To maintain the token character of the rupee, the price of its silver content must be lower than its face value. We have fully dealt with it in a previous Chapter. This is a serious defect in an exchange standard under which the notes are always internally convertible into silver rupees and not into gold. If the price of silver would rise above 48*d.* per ounce of standard silver, the rupee of 1*s.* 6*d.* (gold) would cease to be a token coin. Under such circumstances the Government should have to stop the coinage of rupees and either to coin rupees with less silver content or to replace the rupees by small notes. In an exchange standard, we repeat once more, rupees should always be the main currency into which the notes are convertible. A silver rupee with less silver content was almost unthinkable and practically impossible. The present rupee with its weight and fineness had been the standard of value in India for a very long time, and any change in its weight was likely to cause a good deal the unsettlement in the minds of the people. "The status of the rupee must not be adversely affected unless there is something better to take its place." This dictum of the Commissioners about the historical importance of the rupee and the inadvisability of any change in its weight and fineness had also the sanction of the Babington Smith Committee.

But the chief defect of a gold exchange, according to the Commission, was that it had not that simplicity which was essential to secure the confidence

of the public in it. The mechanism of exchange standard was too difficult for an uninstructed people to understand. In the opinion of the Commission the people of India required a gold backing for their currency; in gold only they had confidence. This criticism of the exchange standard is just and appropriate. The people of India, it is rightly believed, have never understood the working of an exchange standard; they are suspicious of it and have consequently no confidence in it.

For these reasons the Commission concluded that a gold exchange standard would not provide any remedy for the defects of the standard that existed then. They emphasised the fact that the only method to remedy these defects and ensure popular confidence in the currency was to link it to gold into which the domestic currency would be converted *at the will* of the holder, in other words to have a gold standard.

Gold Currency

The Commission also discussed the merits and the advisability of a gold currency for India. The question was an old one; it was before the Fowler Committee and the Chamberlain Commission*. Both the Herschell Fowler Committees favoured such a scheme and recommended its adoption by the Government of India. We know what attempts the Government made to put the scheme into practice and how they failed†.

A scheme for a gold standard and a gold currency was placed before the Hilton Young Commission by the Government of India. *The main provisions of the scheme were:—*

1. That gold coins and bank notes should be unlimited legal tender; rupees would be legal tender upto Rs. 50 only.

* See Chapters V and VIII.

† See Chapter, VI.

2. That a statutory obligation should be placed on the Government to give gold coins in exchange for gold bullion.

3. That a statutory obligation should be placed on the Bank to buy gold.

4. That bank notes should be payable on demand in gold coins.

5. That the Bank *i.e.* the Imperial Bank, should undertake to keep the Secretary of State supplied with funds to meet the sterling charges of the Government.

This scheme had two objects in view:—

1. It would, in the first place, replace the rupees by gold coins and thus eliminate the possibility of the rupee losing its token character by a rise in the price of silver. Under this system the rupee would cease to be unlimited legal tender. It would also simplify the constitution of the Reserve which would not be required to hold any silver.

2. In the second place, it would bring out gold from the hoards as the people would be assured that their gold would have the same value both as coins and as a precious metal. Thus it would also cure the people of the uneconomic habit of hoarding.

The Commission discussed the possibility of a gold currency for India and rejected the proposal on the following grounds:—

1. If a gold currency was to be introduced in India, there would be a heavy demand for gold. The effect of such a demand for gold would raise its value and lower gold prices all over the world, particularly at a time when the European countries were

trying to bring their currencies back to gold standard. It was feared that unless great economy was exercised in the use of gold, there was every possibility of having a long period of falling prices throughout the world. This conclusion was based on the evidence of such eminent economists as Prof. G. Cassel Dr. Hollander of America and the Rt. Hon'ble M. Norman, the Governor of the Bank of England who held that the annual production of gold would not keep pace with the economic progress of the world for some years to come and feared that the scarcity of gold would lead to a fall of prices all over the world.

Indian demand for gold would aggravate and complicate the situation.

A heavy demand for gold by the various European powers would not only lead to a fall in the gold prices but also to a curtailment of credit. "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." A fall in gold prices of commodities would be aggravated by the Indian demand for gold. The present depression (*i.e.* of the year 1932) is due to a certain extent to this cause. It was also suggested to the Commission that America had much gold to spare and that it would be profitable for America and advantageous to the world at large, if America sold off a part of this gold. From the evidence that they received from the United States of America, the Commission found that all the superfluous gold that America had, would be required to enable the European States to resume gold standard and to meet her own growing needs. There was no gold to spare for India.

One is constrained to say that the entire argument of the Commission was based on the assumption

that India was to care more for the requirements of others than her own. This view is narrow and one-sided. In spite of the fact that there was a shortage of gold and the likelihood of a fall in the price-level, all those countries which abandoned gold standard during the war were at that time, in the language of the Commission, trying to climb back to gold standard. They all resumed gold standard shortly after the publication of the report of the Commission. But the Commissioners would not allow India to have a gold currency because others might suffer.

2. In the second place, the Commissioners apprehended that the amount of gold required to have a gold currency could not be definitely estimated. The Government estimated that their scheme would require gold worth Rs. 137·2 crores, or £103 millions or Rs. 27·2 crores additional for the Reserve plus Rs. 110 crores for the conversion of the rupees. Neither could one be sure that the additional amount of gold required for a gold currency could be spread, as suggested by the Government, over a period of ten years. As gold had a prestige of its own it was likely to be a favourite with the people who might prefer it to notes and get the latter cashed in gold. In case of such an eventuality more gold would be required than the Government had estimated. There were other dangers too. A decline in the value of silver which a gold currency was sure to bring about was likely to induce the people to absorb gold, in place of silver, for non-productive purposes; and this would increase the demand for gold still more. Another serious danger was that the reduction of the gold and sterling securities of the Reserves to 30 per cent of its holding, which the Government proposed, might fail to maintain the external value of the rupee during the transition period.

The Commissioners held that the calculation of the Government that the initial demand for gold would amount to 50 crores of rupees was not reliable. As soon as people would come to know that the rupee was to lose its legal tender and fall in value, they, in order to get rid of their silver, might make an immediate demand for gold in exchange for their rupees and thus render the situation extremely difficult.

3. The Commission then examined the effects of a gold currency (a) on silver market, (b) on silver hoards and (c) on China, a silver-using Country.

(a) The demonetisation of the rupee and sale of the silver, content of about 200 crores of rupees or 687 million ozs. would bring about, in the opinion of the Commission, the price of silver. Demand for silver was already decreasing everywhere; both in Europe and in the East paper notes and nickel coins were being used in place of silver in greater quantities than before. Further a fall in the price of silver would not affect very much its production as two-thirds of silver was produced as a bye-product of base metal or in conjunction with gold. These considerations led the Commission to conclude that if silver were demonetised and if India was to sell off a part of her redundant silver which amounted to 687 million fine ozs. i. e., three times the world's annual production and to meet her normal demand for silver by melting rupees the price of silver might fall below 24*d.* per ounce. We can not help noting here that the price of silver has fallen considerably below 24*d.* this year, though the rupee remains enthroned in its position.

(b) The Commission also held that the fall in the value of the silver in which the Indians had placed their trust would inflict heavy losses on the poor whose hoards might depreciate by as much as 50 per cent.

(c) A heavy fall in the price of silver might induce China, the only great silver-using country of the world, to give up silver and secure some form of gold exchange standard. If China was to adopt a gold standard, there would be a further fall in the price of silver. Moreover Chinese demand for gold would raise its value further and depreciate silver still more. A fall in the price of silver would lower materially the purchasing power of China, as it has done this year (1932) which, in the language of the Commission, consequently should have to close its doors against foreign trade, i. e., China would not be able to buy foreign articles. This would bring about world wide dislocation of trade. India would also lose a good market because China had been importing a fairly large quantity of her cotton and cotton goods.

4. There would also be very great difficulties in raising the required credits, as the Commissioners were afraid that America which would be hard hit by the proposal might not render any help to the Government of India to carry out their proposal. Such a proposal was likely to affect very adversely the American silver industry, a growing and important industry in which America had "great and traditional interest." In view of these facts the Commissioners were afraid that the Americans would not be expected to support such proposal. But without American co-operation it was difficult to imagine how the scheme could be carried out. The Indian authorities must realise that such a scheme could not be carried out if a sufficient amount of gold required for the purpose could not be obtained.

5. Lastly the Commission pointed out that such a gold currency would be very expensive. According to Mr. Denning of the Finance Department of the Government of India, the scheme would cost 1'65 crores per annum during the first five years and 1'12

crores thereafter. Sir Basil Blacket, the Finance Member, reduced the cost to two-thirds of a crore after the transitional period*.

The Commissioners, in view of these reasons, were unable to accept the proposal of a gold currency for India. Such a proposal had two objects in view, *viz.*, the curing of the hoarding habit of the people and educating them in the habits of banking. The Commission feared that there was little chance of gaining these objects as the habit of hoarding, in their opinion, had been ingrained in Indian nature and had persisted even in times of peace and safety. Moreover if the objects could be gained at all, they could be gained, in the opinion of the Commissioners, at the cost of very great risks. In summing up the situation the Commission concluded, "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." All that we need say is that too much attention was paid by the Commission to the well-being of other nations and too little to that of India. We shall not be understood, however, to suggest that a gold currency is the best currency, or a gold standard is the best standard; gold may have nothing but the smell of its prestige. The Commissioners, however, refused to accept any scheme which, by depriving the legal tender character of the rupee or by the sale of a large quantity of silver, would dislocate the market, pull down the price of silver to a very low level and create widespread commercial disturbance.

* For the detailed scheme See Appendix A.

Gold Bullion Standard

The Commissioners recommended a standard in which the internal currency was to be linked directly to gold though there might not be a gold currency at all. In fact they held that, though the new standard would be a gold standard, there might not be an active gold currency. "The essence of the proposal is that the ordinary medium of circulation should remain, as at present, 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 *for all purposes*, but that gold should not circulate as money. It must not circulate at first, and it need not circulate ever."

Objections to gold circulation. The Commission, objected to the circulation of gold mainly on the ground that the gold which was to be put into circulation was to come from the reserve, thus reducing it by the amount to be put into circulation. A reduction of the reserve would make the currency system inelastic to a great extent; the more the gold in the reserves, the greater would be the elasticity of the credit which could be built upon it. Further, "Gold in circulation is of uncertain value for the support of exchange." The Commission accepted this view of the Chamberlain Commission on the subject and held that the scheme outlined by them (see below) would create confidence in the stability of the currency and at the same time could be put into practice without the evils attendant upon a gold currency, *viz.*, inelasticity, expensiveness and other similar evils stated in the preceding pages. Further the scheme would not close the doors against the introduction of a gold currency in future, though the Commission hoped that such a step might not be thought necessary at all. The Commission, in view of these facts, deprecated the introduction of a gold currency in India.

Gold Bullion Standard. The new currency system which was recommended by the Commission might be called *gold bullion standard*. According to this system the Government should have a statutory obligation to buy and sell gold *freely without any limit* either for rupees or notes in quantities not less than 400 fine ounces at a fixed gold parity of the rupee, *both for internal and external purposes*. Thus in the first place the rupee would be linked to gold and not to sterling. In the second place free convertibility of the rupee and the notes into gold *for any purpose* would make the new standard a gold standard. In an exchange standard rupees are legally inconvertible for internal purposes; they are convertible into gold only for external purposes. In the third place the scheme would secure the automatic expansion and contraction of the currency, which was wanting in the exchange standard but went so long unnoticed. When gold bars would be given to the currency authorities and notes or rupees taken out in return, the currency would be automatically expanded; similarly when gold bars would be sold for rupees or notes, the currency would be automatically contracted. In the fourth place the gold price of the rupee would be made stable by making it obligatory on the Government to buy and sell gold at a fixed parity. This system, the Commissioners held, would possess all the requirements of a currency essential for a country like India; *it would be simple, certain and stable*. It would provide the token currency with the right of convertibility which would be intelligible to the uninstructed and it would establish a gold standard in India. Further it would discourage hoarding habit and induce the people to bring out their hoards and invest them. There was no fear that such a currency would induce the people to get their silver hoards converted into gold; silver rupees

under this scheme would retain their legal tender character; and hence there would be no incentive on the part of the people to get rid of their silver hoards. The existence of a large amount of currency in hoard was a very great danger to the efficient working of the currency system. It would be difficult, as it had been in the past, to expand and contract the currency according to the requirements of trade as long as these hoards would exist. An attempt to contract the currency might be frustrated by an unexpected appearance of a large volume of currency from the hoards; similarly an expansion might be hampered if a part of the currency would disappear from circulation. To put a stop to this process the Commission recommended the withdrawal of the legal tender character of the sovereigns and half-sovereigns so that the gold portion of the hoards might not affect at all the volume of currency; the silver portion would be rendered innocuous by being converted into gold bars.

Buying and selling rates for gold— In the language of the Commission, a sound gold standard postulates a statutory obligation upon the currency authority to buy and sell gold at a price equivalent to the par value of the monetary unit. This obligation constitutes the cardinal condition and compelling force for the maintenance of monetary stability in relation to gold. In the case of India this task of selling gold freely, the Commission recognised, would be difficult as gold in a large amount was required by the people for other than monetary purposes. There was already a bullion market in India where gold had been sold at a price which covered the cost of importing it and a profit for the dealers. The Indian Government could not be asked to sell gold at the par value of the rupee, as such a step would not only make India the cheapest market for gold but would also close down the existing

market. Moreover the Government should not undertake the task of selling gold to the people for all purposes. The Commission laid down that when exchange would lie at the upper point, the selling price for delivery at Bombay would be the par value, *i. e.*, Rs. 21-3-10 per tola; when exchange would go below this point, the Bank would sell for delivery in London or at Bombay at certain notified prices. These prices would be determined by the cost at which gold could be respectively purchased in London or laid down in Bombay from London when exchange would be at the lower point.

As the Government of India should have to sell and buy gold bars *for all purposes*, there should not be, in the opinion of the Commission, any gold coin with legal tender character; neither should there be any necessity for minting such coins until the amount of gold in the reserve would be large enough to make possible the introduction of a gold currency, provided such a currency was thought desirable. The Commission, therefore, recommended that the legal tender quality of the sovereigns and the half-sovereigns should be removed. For sometime past the gold sovereigns had ceased to function as currency owing to the fact that their, statutory value *i. e.* Rs. 10, was much lower than their market value. The removal of their legal character quality would not also affect the gold hoards; gold coins were full-bodied coins and would fetch the same value both as coins and as commodities. Moreover this removal of the legal tender character of the sovereigns and half-sovereigns would make them innocuous; they would not be able in future to affect the contraction or expansion of the currency.

Saving Certificates payable in gold. The Commission noted that as buying and selling of gold in

quantities of 400 ounces would be confined in the beginning only to bullion brokers and banks, the ordinary people would seldom come to know of the change in their currency system. The Commission, therefore, proposed that a more direct and tangible method should be adopted to bring home to the masses that gold was the standard of value of the rupee and that the rupee was convertible into gold at *the option of the holder*. The method suggested by the Commissioners was the issue of saving certificates, payable in three or five years, in legal tender money or in gold at the option of the holder. Such certificates might be issued in denominations of one tola and its integral number and sold for rupees and notes at an attractive interest. They were to be of the nature of cash certificates. They could be cashed in rupees only and not in gold if they were to be cashed before their maturity at a discount reckoned at varying rates according to the date of encashment. As soon as these certificates would mature, the holders would get either legal tender money or gold at their option and would thus receive a striking proof of the existence of gold standard and the benefits of investment. The Commission hoped that as soon as the people would learn that they would get gold for their certificates, they might be expected to get their hoards replaced by them. This would confer great benefits on the country as stores of wealth, the Commission believed, "great in the aggregate and lying wastefully inert" would be taken from the hoards and used for productive capital expenditure. "The offer of such certificates should constitute a powerful incentive to investment and a powerful antidote to hoarding."

Convertibility of notes into silver rupees. Another recommendation of the Commission was to make the

notes inconvertible into rupees. It was an anomaly, the Commission said, that one form of note, the paper note, should be convertible into another kind of note, the rupee. This provision had two great defects. In the first place it would cause serious loss to the Government when the price of silver would rise above a certain point. In the second place, it had compelled the Government to keep in the reserves a large stock of silver to ensure the convertibility of the notes; their silver was useless for external convertibility. As far as the notes already in circulation were concerned, they should always be convertible into rupees; only the new notes (see Chapter XIV) to be issued, as suggested by the Commission, should lose this right of convertibility. The Commission pointed out in this connection that the people of India had for centuries been habituated to the use of a metallic currency and though one-rupee note had been very popular among them, it would be unwise to force paper money on the people against their wishes. In their opinion the best method to popularise the currency notes was to make them readily convertible into the metallic currency which the people demanded and to afford them practical facilities for such conversion. If such facilities were withdrawn, the Commission feared, the growth of the note-issue and its popularity must be endangered. For these reasons the Commission wanted to make it incumbent on the currency authorities to make rupees and other coins duly available to the public. There were at that time 85 crores of silver coin and bullion in the reserves; more might come out from the hoards. There would thus be enough rupees to convert the notes into the former. The Commission, therefore, recommended that the fresh coinage of silver rupees should be stopped for a long time until the amount of rupees in circulation was reduced to the amount re-

quired for small change. If this was done, the change in the legal status of the notes could hardly be felt for a long time. The Commission also recommended the issue of one-rupee notes which would be full legal tender and inconvertible into rupees. The new notes, other than one-rupee notes, should have a right to be converted into legal tender money, *i.e., into notes of smaller denominations or silver rupees at the option of the Government.* This provision would give the currency authority the option to determine the form of the legal tender money to be supplied to the public. The Commission were opposed to any alteration in the legal tender character of the silver rupees.

Reserves. With regard to the reserves the Commission suggested that the two reserves should be amalgamated as, in the first place, there was no clear demarcation between their functions (they often perform the same function). The combined reserve should have its proportion and composition fixed by Statute. This would secure an automatic expansion and contraction.

In the second place the Commission proposed that gold and gold securities should not be less than 40 per cent of the reserve. The authorities would do well to raise the gold portion of the reserve even to 50 or 60 per cent. The Commission advised that the gold in the reserve which stood at 12·8 per cent. in 1926 should be raised to 20 per cent. in 5 years and 25 per cent. in 20 years. Such a high percentage was thought necessary to enable the authorities to encash the gold saving certificates, to sell and buy gold to an unlimited extent at a fixed price and finally to pay for the new notes. The silver portion of the reserve would be out of place in a gold standard. There were enough silver rupees to meet the demand

of the people. As the stock of rupees in the reserve, estimated at Rs. 85 crores, was considered unduly large, the Commission advised the reduction of the rupee stock to 25 crores in the course of ten years. The rest of the Reserve should be kept in rupee securities and might amount to 25 per cent of the Reserve or Rs. 50 crores, whichever would be less.

Position of the rupee.

It would be interesting to sum up the position of the rupee under the scheme formulated above and recommended by the Commission. In the beginning the position of the rupee, the standard and store of value in India, should remain unchanged. "We are bodily opposed," said the Commission, "to any alteration in the legal tender character of the rupees". But the Commission pointed out the absurdity and anomaly of the Indian currency system which provided the conversion of one form of note, the paper note, into another form of note, the silver notes and strongly urged for a termination of this state of affairs. The new notes to be issued by the Reserve Bank, as recommended by the Commissioners, should lose the right of convertibility. The Commission hoped that when the new notes would become popular, they would slowly replace the metallic currency which, in consequence, would lose its predominant position in our currency system and come to occupy in future only a subordinate place. In course of time the main currency would consist of paper notes which would be cheaper than silver notes and which would also eliminate the danger which had threatened the silver currency in the past. This change, however, was to come very slowly. The Commission observed that the people of India had for centuries been habituated to a metallic currency; any sudden attempt on the part

of the Government to deprive them of it and make the notes inconvertible was likely to shake seriously their confidence in the new currency which, in consequence, might take a long time to get into circulation. In the opinion of the Commission "the best way to foster the use of currency notes is to establish confidence in their practical convertibility"; for these reasons the Commission advised the currency authorities to make rupees and other coins freely available to the public in such quantities as might be required for circulation. The Commission hoped that when no rupees would be required in the reserve for the convertibility of the notes, when the public had been made familiar with the use of one rupee notes and when all forms of internal currencies would be firmly based on gold, no insuperable difficulty would be felt in meeting the situation, should the silver rupee owing to a rise in the price of silver above the 'melting-point' disappear from circulation.

Stabilisation of the rupee

One of the most important and vexed questions in Indian currency and exchange is how to fix the gold value of the rupee and stabilise it at that parity. The Commission held that as the United Kingdom, the Dominions, and many other countries had returned to gold standard and had thus stabilised their currency, India should follow suit and fix the gold parity of the rupee forthwith. It was pointed out to the Commission that the rupee should be left to itself with a view to mitigating the internal price movement. The Commission, however, refused to take this view into consideration, though it must be admitted that the view ought to have carried some weight and received careful consideration at the hands of the Commission. The Commission decided that time had already

come when the rupee was to be stabilised at a fixed gold parity. An unstable rupee, as it was pointed out by the Fowler Committee, introduces an element of uncertainty and speculation in trade and often hampers and clogs it.

The Commission proceeded to fix the gold price of the rupee in spite of the fact that there were certain elements of instability in the economic conditions of certain countries owing to the absence of currency stability in them.

1s. 6d. gold for rupee. The Commission recommended *1s. 6d.* as the gold parity of the rupee. The reasons which led the Commission to recommend this price were as follows :—

1. *De facto rate.* Firstly, the price of the rupee had been in the neighbourhood of *1s. 6d.* gold since June, 1925 and *1s. 6d.* sterling since October 1924; so it was the *de facto rate*, and the rupee should be, in the opinion of the Commission, stabilised at that rate. Sterling became equivalent to gold in April, 1925.

2. *Stability of price.* Secondly, in the opinion of the majority of the Commissioners, at *1s. 6d.* the price-level in India had adjusted itself with that of the world at large. This was the most weighty consideration with the Commission. That being so, the Commission feared that any change in the price of the rupee would disturb trade and cause "widespread economic disturbance which it was in the interest of the people to avoid." The Commissioners held—they were unanimous in this opinion—that if it could be shown that prices had adjusted themselves to the *de facto rate*, *i. e.* *1s. 6d.* gold, the price of the rupee must be fixed at that parity. They found, with the exception of Sir Parshotamdas Thakardas, that the Indian prices had adjusted themselves with the world prices at that parity. To find out

this, the Commission depended on index number, making allowances for those mistakes which the index number is liable to. From December, 1922 to June, 1924 the exchange value of the rupee, as measured by Calcutta-London-New York rate, remained stable round 1s. 3d. gold; during the same period the rupee price-level, as measured by the Calcutta wholesale index number, remained fairly steady round 176, varying between 170 and 181. From July, 1924 to January, 1925 the gold value of the rupee rose from 1s. 3d. to 1s. 6d., and since May, 1925 it had been held within 1s. 6d. gold points; from July, 1924 to June, 1925 the rupee level fell from 177 to 159, and since then varied between 163 to 153. The following table will illustrate the rise and fall indicated above :—

Period	Value of rupee	Index figure of prices in India	Index figure of world prices
I. December 1922— June 1924	1s. 3d. gold	176 (Varying between 170 & 181)	the same
II. July 1924 —January 1925	1s. 6d. gold	157 (fell from 179)	
III. June 1925 —March 1926	1s. 6d. gold	158 (between 163-153)	Approximate-ly the same

The table brings out the following facts:—

(a) During the first period the gold value of the rupee was about 1s. 3d., and the price-level ranged round a mean of about 176. The index figures of the United Kingdom and the United States were the same.

(b) During the third period the rupee moved round 1s. 6d. gold and the mean price-level was about 158. The world price-level, as indicated by the index figures of the United Kingdom and the United States, was 158 during that period. In the opinion of the Commission this was a conclusive proof that the Indian prices had adjusted themselves with the world prices at 1s. 6d. gold per rupee.*

3. During the last 12 months, *i. e.*, since June 1925 the exchange had been very steady. A steady exchange for a long period would prove that the internal and external prices had been adjusted. This was another proof that the price of the rupee had been fixed at 1s. 6d.

4. Lastly the Commission argued that if there had been any difference between the external and internal price-levels, the exports or the imports would have been handicapped. If prices were higher in India, imports would increase and exports would decrease; if they were lower, they would stimulate exports and hinder imports. From the fact that the general trade of the country had not suffered from any such handicap, the Commission concluded that there had been adjustment of prices, internal and external, at 1s. 6d. gold.

Adjustment of Wages. The Commission then proceeded to find out whether wages had adjusted themselves to the new price-level. They held from an ex-

* See Purchasing Power Parity, pages 23 to 25 and Chapter XV.

amination of facts that the Indian wages had also been adjusted to the new price. Prices are bound to react on wages. As prices go up, wages are likely to rise, and as they fall, wages decline; the effects, however, take a long time to manifest themselves. Further if exchange and wages, in the opinion of the Commission, remain steady for a considerable time, it may be assumed, unless there are indications to the contrary, that wages have adjusted themselves to prices. From these two theories the Commission concluded that the wages had been adjusted to the price-level. With regard to agricultural wages the Commission held that there had not been any general mal-adjustment. With regard to manufacturing industries the Commission held the same view. In the jute industry of Bengal, though during the period of high prices the industries increased temporarily the wages of the labourers, the latter were brought later in line with the lower price-level and cost of living. The Chairman of the Bombay Millowners' Association told the Commissioners that the index number of wages of millhands had gone up to 231 from 100 in 1914 (the base year) and that attempts to reduce the wages had failed and suggested the reduction of the exchange to 1s. 4d. Such a reduction, in the opinion of the Commission, could bring about only a temporary relief; ultimately this reduction, by inflating the currency by 12½ per cent. would raise the prices and reduce the real wages by an equivalent amount. The Commission opposed any attempt to reduce wages by a manipulation of the currency.

Effects on contracts. The Commission then considered the effects of high exchange on contracts. Most of the land revenue settlement was made at a time when the exchange stood at 1s. 4d. By raising the exchange to s. 6d., it was pointed out, the burden of taxation

would be increased by $12\frac{1}{2}$ per cent. But the Commission pointed out that since 1914 there had been a rise in prices, and, therefore, measured in terms of commodities, 1s. 6d. would not constitute great hardship to the peasants. This argument may be explained thus: When exchange was at 1s. 4d. per rupee, the cultivators got Rs. 15=£1 for a given quantity of produce. When the exchange was fixed at 1s. 6d., for the same quantity of produce, they would get only Rs. 13-5-6 (which was equal to £ 1). This argument holds good only if the price-level is taken to be stationary. If however, prices rise, as they did in 1925, the argument takes a different line. If prices increase, a fixed quantity of produce which formerly brought one £ will now fetch more than £1 and consequently more than Rs. 13-5-6.

With regard to other contracts, the Commission held that the Indian exchange had been unsteady since 1918, up to which year exchange was fixed at 1s. 4d. The Commission believed that the contracts and agreements concluded prior to 1918 were fewer in number than those concluded subsequent to 1918; they also admitted that after a long period of disturbance it was not possible to do justice to long-term debtors and creditors and held that the great bulk of the contracts was for short terms and was contracted when exchange had reached 1s. 6d. (gold) or had broken away from 1s. 4d.

From these facts the Commission concluded that from the point of view of contracts as well as from that of prices and wages, the least disturbance would be caused, and the least injury would be done to all interests concerned by adhering to the de facto rate.

Arguments against 1s. 4d. The Commission could not see their way to accept 1s. 4d. as the price

of the rupee. Many witnesses appearing before the Commission urged 1s. 4d. in the place of 1s. 6d. as 1s. 4d. appeared to them to be the *natural rate*. In the opinion of the Commission a natural rate is one in which internal prices are in adjustment with volume of currency and with the external prices. Fluctuations in exchange are produced by the interaction of internal and external prices; internal prices are determined by the volume of currency in circulation. According to this theory 1s. 6d. was the 'natural' rate as at that rate the adjustment between external and internal prices and with the internal currency had taken place. The Commission put another interpretation on the term 'natural.' Very likely, the Commission said, the term intended to indicate a rate which would be fixed without any interference by the executive. In that case the Commission held that owing to seasonal fluctuations of trade, the rate of exchange would move up and down, and consequently it would be difficult to distinguish any rate as the 'natural' rate. Sir J. C. Coyajee in two brochures issued in 1928 and 1930* held the same opinion and failed to understand what the word "natural" meant here. But it was clear what the witnesses meant. What they meant was the rate that had been maintained from 1898-1918 for a period of 20 years. In support of this 'natural' rate it was pointed out to the Commission that in April, 1926 the rate was falling below 1s. 5¼d., and the Government prevented its further fall by the sale of Reverse Bills. In October 1925 when the rate was rising above 1s. 6d., the Commission pointed out, that the Government interference in the shape of purchase of sterling prevented it from rising further. The Commission held that the rise of the rate

* India's Currency, Exchange and Banking Problems, page 35 and Ratio Controversy, page 3.

in 1925 was kept down by large purchase of sterling and consequently by an expansion of the currency, otherwise the rate would have risen above 1s. 6d. In the opinion of the Commissioners the fall in April, 1925 was not due to any trade depression but to the speculation indulged in by the merchants on the possibility of a fall of the exchange below 1s. 6d. What the Commission implied was that the fall was temporary and artificial. This statement was partly confirmed by the fact that as soon as the Reverse Bills were offered at 1s. 6d. lower gold point and currency was contracted, and the fall was stopped. It was also argued in support of 1s. 4d. that, though prices might have adjusted themselves to 1s. 6d. for a considerable time, the rate 1s. 6d. had been brought about by the manipulation of currency by the Government and therefore it could be disturbed more easily and with less harmful results than 1s. 4d. which could have been brought about by the interplay of commercial forces. The Commission answered that even if this was the fact, prices and other trade conditions had been adjusted to 1s. 6d.; the exchange should therefore, be fixed at that rate, i. e. 1s. 6d. It mattered little by what method exchange had been fixed at 1s. 6d.; what mattered was what was the actual rate. If it was 1s. 6d., the rupee should be stabilised at it. Another argument in favour of 1s. 4d. was that if the rupee could be fixed at that rate, less gold would be required for the conversion of the rupees and notes, which a gold standard, recommended by the Commission, would necessitate. Further in case of a weak exchange brought about by a failure of monsoon and an adverse balance of trade 1s. 4d. stood a better chance of being maintained than 1s. 6d., because at 1s. 4d. Rs. 15 would be equal to £1, though at 1s. 6d. Rs. 13-5-6

would be equivalent to £1, i. e., at 1s. 4d. less gold would be required to pay for a certain amount of rupees. Both these arguments were rejected by the Commission. With regard to the first argument the Commission pointed out that the supporters of 1s. 4d. had overlooked the fact that the reduction of the gold value of the rupee by $12\frac{1}{2}$ per cent would call for an expansion of the currency to the same extent, otherwise prices would fall and trade would be disturbed. The amount of gold, therefore, required to support the circulation, would remain the same in either case. In answer to the second objection the Commissioners said that with a central currency and banking authority it would not be more difficult to maintain 1s. 6d. than 1s. 4d., provided the gold securities in the reserve were sufficient to effect the necessary contraction of the rupee circulation.

The other two arguments urged in favour of 1s. 4d. were:—(1) that 1s. 4d. would raise the price of gold in terms of silver and thus would provide a check to the enormous absorption of gold which had taken place in India in recent years. At 1s. 6d. one pound gold would be equivalent to Rs. 13-5-4; but at 1s. 4d. it would be equal to Rs 15. Thus gold at 1s. 6d. per rupee would be cheaper than gold at 1s. 4d. per rupee. The Commission suggested that by increasing the rupee price of gold by lowering the exchange would not cure this ingrained habit of the people; the only sure way to eradicate this wasteful habit was to “stabilise the currency, establish confidence in its stability, educate people in the habit of investment and extend banking facilities.”

(2) That as in future there was a likelihood of a fall in the gold prices of commodities owing to shortage of gold, 1s. 6d., i. e., the high gold value of

the rupee would accentuate this fall in India and embarrass the situation just as it did in 1920. The Commission thought there was not much apprehension on that score. The abnormal conditions of 1920 were due mainly to the enormous increase of credit to meet an emergency created by a prolonged and wearisome war which threw out of gear the whole economic structure of the world. Such a catastrophic disturbance was over, and future movements of price, the Commission thought, would proceed on normal lines. This prediction of the Commission has been utterly falsified, and a catastrophic disturbance, more serious and extensive in nature than contemplated by the Commission has upset all calculations and has left a deficit in all budgets.

Economic effects of 1s. 4d. On the other hand, the effect of a reversion to 1s. 4d. on prices, wages and international trade, the Commission thought, would be very disastrous. Even if it was admitted that wages and prices had not been adjusted to 1s. 6d., no one would seriously suggest, contended the Commission, that they had been adjusted to 1s. 4d. From 1917 to 1925 there were wide fluctuations both in prices and exchange, and no rate was stable during this period; if any rate could be said to have adjusted itself to prices and wages, it was 1s. 6d. which had been stable for over one year. A reversion to 1s. 4d. would produce a general rise in prices by $12\frac{1}{2}$ per cent and would thus cause much hardship to the consumers, particularly to the poorer paid members of the literate class. 1s. 4d. would raise the price-level, reduce the real wages of the labourers and inflict much hardship on them.

The immediate effect of a reversion to 1s. 4d. on internal trade would be of a "convulsive" nature. The Commission feared that as soon as the policy of adopting a lower rate, i. e. 1s. 4d. would be announced—

the rate was then 1s. 6d.—people who had to remit money abroad, would at once try to send money at the higher rate, and would thus bring down the exchange. Again as soon as the new rate would be adopted, the tide would turn the other way about; there would then be a very large demand for rupees, which could be met by an offer to sell Council Drafts without limit which could only be cashed by additional currency. This might lead to a series of violent fluctuations in exchange.

Effect on public finance. The effect on public finance would be still more serious. In the opinion of the Commission, "a reversion to 1s. 4d. would inevitably lead to increases in both the central and provincial taxation, and would probably also result in a postponement of further remissions of the provincial contributions to the central revenues and a setback to the development of nation-building projects in the provinces." In the case of the Government of India, the Commission pointed out that the adoption of 1s. 4d. in 1926-27 would at once increase the sterling expenditure by 3 crores of rupees per annum, destroy all budgetary equilibrium and impair India's credit abroad. There would also be similar immediate increase in the Railway budget. There would also be some extra expenditure, owing to a rise in prices, on stores purchased in India and some re-adjustment might have to be made in the salaries of Government servants too, who would be effected adversely by the increased cost of living. Though no definite estimate could be made of the increase in expenditure, it was clear, the Commission held, that the immediate loss to the public finance would be considerable.

In the Provinces, it was pointed out, that the lowering of the exchange would cause a further rise in

prices which might call for a revision of the salaries of the Government servants. For such a revision additional taxes had to be levied on the taxpayers who would himself be affected by the rise in prices and such taxes, it was feared, would cause widespread discontent in the country.

Minor considerations. In support of 1s. 6d., the Commission argued that the rupee at 1s. 4d. would cease to be a token coin when silver would sell at 43d. per ounce but at 1s. 6d. it would cease to be so at about 48d. per ounce. Though there was no chance for silver to rise either to 43 or 48d. per ounce in future, 1s. 6d. would be a safer rate than 1s. 4d. The contention that at 1s. 4d. one sovereign would be equivalent to Rs. 15 was a very minor one and would lose all its force when the legal tender character of the sovereign would be withdrawn as suggested by the Commission.

Conclusion. From these considerations the Commission concluded that the rupee should be fixed at 1s. 6d. gold. The opportunity of fixing the rupee at the historic rate of 1s. 4d. had gone; for the interests of India 1s. 6d. would be much better than 1s. 4d.

Miscellaneous recommendation.

Banking development. The Commission emphasised the importance of improving banking facilities which would draw the hoards and provide cheap facilities to the public for internal purposes. In this connection the Commission urged the abolition of stamp duties on cheques as stamps on cheques had a tendency to restrain many people from opening accounts. In the United States there was a similar duty on cheques; but as it was found to be a restraint upon the use of cheques, it was abolished. A similar course in India might be followed with very satisfactory results.

Statistical material. There should also be reliable and complete statistical data in a good currency system, absence of which might seriously hamper the activities of the currency authorities.

Note of Dissent

It would be worth our while to turn our attention now to the other side of the picture as presented by Sir Purshotamdas Thakardas in his note of dissent. Sir Purshotamdas dissented on many points from the views and arguments of the majority and held: (1) that there was no justification for fixing the rupee at 1s. 6d. and (2) that 1s. 4d. was more suitable to India. We shall not deal with the historical part of his note in which he surveyed the whole history of Indian currency as it developed from time to time from 1898 to 1918. He severely attacked the recommendations of the majority who wanted to fix the gold price of the rupee at 1s. 6d. He was unable to accept the statement "that 1s. 6d. was the defacto ratio, that prices, wages, contracts and public finances, in other words, conditions generally had adjusted themselves to it or that the least injury would be done to all interests by accepting it."* He would go in for 1s. 4d. as 1s. 6d. was, in his opinion, neither the defacto rate nor the one to which wages and prices had been adjusted.

1. In the first place he argued that 1s. 4d. had been in force for 25 years from 1893 to 1918 when it was changed and raised to 2s. gold by the Babington Smith Committee, a rate which ever remained ineffective. The Government attempted to maintain this "unnatural" rate by selling Reverse Council Bills to the tune of £55½ millions and contraction of Currency to the extent of Rs. 35 crores. (see page 195). In spite of

* See page 238.

this, the attempt failed, and the Government had to abandon 2s. gold as impracticable. (see page 196).

This rate was recommended by the Fowler and the Herschell Committees and the Government stood committed to it.

2. Though from 1918 onwards the rate fluctuated violently, there was an opportunity in September 1924 to stabilise the rupee at 1s. 4d. The Government threw away the opportunity; to quote their own words, they "were waiting for a permanently higher rate than 1s. 4d." The unavoidable conclusion which Sir Purshotamdas drew from these facts was that the Government could have easily restored the rupee to 1s. 4d., had they chosen to do so.

3. Further he held that 1s. 6d. was attained by official manipulation of the currency. This manipulation was effected by preventing the normal expansion of the currency. The pre-war average expansion of the Currency in India was over 20 crores of rupees per annum. From 1921-22 to 1924-25 the expansion or contraction of the Currency was as follows:—

	(In crores) Rs & notes	Sovereigns	Net
1921-22	-1	+3	= +2
1922-23	-6	+9	= +3
1923-24	+15½	+7	= +22½
1924-25	+1	+15	= +16
			—————
			= +43½

The average expansion was about 11·12 crores of rupees a year. This contraction of currency or limits on the possibilities of expansion sent up the Imperial Bank rate to 8 percent. Even the Government had to admit "that the stringency in the market is the

direct outcome of Government action in contracting currency or in placing limits on possibilities of expansion."

4. While the currency was thus "administered" with a view to keep exchange at a higher level than 1s. 4d., the natural method of stopping the rise, *viz.* by the tender of gold at the currency offices, was prevented for practical purposes by keeping the rupee at the fictitious and 'unnatural' rate of 2s. gold. Thus by contracting the currency and preventing people from expanding it by tender of gold, the Government could maintain any rate for any length of time. The implication was that the rate 1s. 6d. was not the natural rate but an artificial one maintained by executive authorities.

5. Even if it was taken for granted that the 1s. 6d. was the *defacto* rate, it had been in force only for one year from June, 1925 when sterling reached its gold parity. From October 1924 to June 1925 the rate was 1s. 6d. sterling and not gold.

6. From March 1926 the rupee had been maintained at 1s. 6d. by deflating the currency to the extent of 8 crores of rupees and by an offer to sell Reverse Councils at 1s. 5 $\frac{3}{4}$ d. These methods adopted to maintain the rupee at 1s. 6d. were artificial. It might be the *de facto* rate, but that *per se* would not entitle it to the slightest weight.

Influence of exchange on prices. The influence of exchange on prices, in the opinion of Sir Purshottamdas, varies in the case of different articles. On articles of exports which are sold abroad the influence is direct and immediate, as such articles are sold in competitive markets and are governed by world prices. On articles consumed internally the influence of the exchange is indirect. A high purchasing power of the rupee will lower internal prices; similarly a low purchasing power

will raise the prices. But this influence on prices is neither automatic nor speedy; it takes a long time to make itself felt. With regard to articles of import a higher exchange would lower their rupee prices and enable them to be sold cheap at home. The consumers will gain in that case; but the extent of the gain depends on how much imported articles are consumed by the people.

No Adjustment to prices. Sir Purshottamdas contended that the argument of the majority that the prices had adjusted themselves to 1s. 6d. was not borne out by index number.

The following table prepared by him will prove the statement:—

Months.	Rupee Index Number (Calcutta)	Sterling Index Number.
June, 1925	157	158
July, 1925	160	
August, 1925	157	
September, 1925	158	
October, 1925	160	
November, 1925	164	
December, 1925	163	
January, 1926	163	
February, 1926	158	149

The rupee reached 1s. 6d. gold in June, 1925, and sterling also reached its pre-war parity in the same month of 1925. The table shows that though sterling prices fell by 9 points from June 1925 to February 1926, Calcutta prices rose by one point during the time.

In other words there had been no adjustment of prices since the rupee touched 1s. 6d. gold in June 1925.

The Bombay prices, given in the table below, indicated that there was a fall in them, but the fall was attributed to a fall in the gold prices themselves all over the world and not to any adjustment of Indian prices to 1s. 6d.

Period.	Bombay Index Number.	U.S.A. Index Number.	United kingdom Index.
July, 1925	158	160	157
February, 1926	152	155	149

Sir Purshotamdas then took the whole course of price-range from December, 1922, to June 1925 to bring out more clearly that the internal prices had not then adjusted themselves to external prices.

It was contended by the majority that the fall in rupee prices in the first half of 1925 "represents the tendency of those prices to adjust themselves to the rise in exchange."

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INDIAN EXCHANGE AND PRICES.

Months.	Dollar-sterling exchange.		Rupee-sterling exchange.			Rupee-dollar exchange.	
	\$	% Gold parity.	Sterling.	Gold.	% Gold parity	\$	% Gold parity.
July, 1922	4.45	91.5	15.67	s. d. 1 2 $\frac{3}{16}$	90	28.89	89
Dec. 1922	4.62	95.0	16.00	1 2 $\frac{27}{32}$	95	30.65	94
June, 1924	4.32	88.8	16.99	1 2 $\frac{15}{16}$	94	30.49	94
July, 1924	4.37	89.8	17.19	1 3 $\frac{1}{8}$	96	31.25	96
August, 1924	4.50	92.5	17.24	1 4	100	32.26	99
June, 1925	4.86	99.9	18.05	1 6 $\frac{1}{16}$	113	36.48	112
Feb. 1926	4.86	99.9	18.19	...	114.	...	—

WHOLESALE PRICE INDEX NUMBER.

	U.S.A.		(1913=100)		Calcutta		Bombay	
	1913=100	1913=100	U.K. Sterling	Gold	1914=100	1914=100	Rupee	Gold
July, 1922	...	155	160	146	18	163	190	179
December, 1922	...	186	156	148	176	165	175	164
June, 1924	...	145	163	145	176	165	185	...
July, 1924	—	147	163	146	179	172	189	...
August, 1924	..	150	165	153	180	180	184	..
June, 1925	..	157	158	158	157	177	160	...
February, 1926	—	155	149	149	158	180	152	—

The gold parity of the rupee rose from 95 in December, 1922 to 113 in June, 1925; during the same period the index number of world gold prices was about the same at the beginning and the end of the period, i.e., 156 and 157 respectively; on the rise of the gold parity of the rupee during this period from 95 to 113, i.e., a rise of 19 per cent, there would have been a corresponding fall in the Indian price-level; Calcutta price-level should have fallen from 176 in December, 1922 to 142.5, but it fell to 157. This would show that the adjustment was not complete.

Taking the whole course of price-level from July, 1922 to February, 1926 one could see that the price-level was exactly the same, i.e., 155, at the beginning and at the end of this period. The gold parity of the rupee was 90 in July, 1922 and 114 in February, 1926, i.e., there was an increase of 27 per cent. The Calcutta index number was 181 in July, 1922 and 158 in February, 1926, i.e., a fall of 23 points. But on a 27 per cent increase in the gold parity of the rupee, a fall of 49 per cent was called for if the Indian prices had been in complete adjustment to world prices. The actual fall, as noticed, was only 23 points; a fall of 26 points, i.e., more than half of the actual fall, had not taken place. The average of the Calcutta and Bombay Index Number in July, 1922 was 185, and that in February, 1926, 155. There was a fall of 30 points, instead of 40, required to bring about adjustment of prices. These facts would go to show that the prices had not adjusted themselves to 1s. 6d.

But there was a further danger. There was a likelihood of a fall in gold prices in future, a supposition which was strengthened by the evidence of such experts as Professor Cassel and Mr. Joseph Kitchin. In the case of such a fall, prices would fall

in India also, but the Indian fall must be bigger than the world fall because of the stabilisation of the rupee at such a high level as 1s. 6d. gold. "In a word it will hit and hit very hard four-fifths of the population of the country that exists on agriculture".

No adjustment of wages. With regard to wages also Sir Purshottamdas held that there had been no such adjustment as was claimed by the majority.

Mr. Gennings of the Labour Bureau of Bombay, in his statement, gave the following figures with regard to the increase in the wages of labour in urban and rural areas in the Bombay Presidency between 1913 and 1925 :—

		Per cent.
Field Labourer	{ Urban areas	121
	{ Rural areas	106
Ordinary Labourer	{ Urban areas	104
	{ Rural areas	86
Skilled Labourer	{ Urban areas	116
	{ Rural areas	109

These figures would show that compared with the wages of 1914 which should be represented by 100, there had not been any decline in wages, though there ought to have been as the rupee had been equivalent to 1s. 6d. gold in place of 1s. 4d.

With regard to industrial wages the figures pointed to the same conclusion, viz., that there had not been any adjustment of prices and wages at 1s. 6d. Wages in the Bombay Cotton Mills were 232 against 100 in 1914; in the jute mills and mines of Bengal the figures were 150 against 100 in 1914. No province had recorded any tendency for these wages to fall. Further Sir Purshottamdas pointed out that no official witness had suggested that owing to an appreciation of the

rupee the Government proposed to decrease the pay of the Government officials.

With regard to clerical wages the official statement prepared by the Bombay Labour Office in 1926 showed that there had been no decrease in such wages since 1914. The official statement is as follows:—

	percentage over 1924
Railway and allied offices	... 78
Semi-Government offices	... 81
Banks	... 79
Commercial offices	... 70

These facts, Sir Purshottamdas concluded, would confirm the view that the wages of the manual labourers and of the lower ranks of clerical workers would not generally undergo reduction in India. The literary and comparatively educated class might reconcile themselves to a fall in wages consequent upon a fall in prices, but the illiterate class, incapable of reasoning, would seldom do so. Further the industries were passing through a depression. Any appreciation of the rupee which 1s. 6d. must bring about would cause a long and bitter struggle between Labour and Capital, as Labour would, as the past had shown, oppose any attempt to reduce their wages.

It was contended by Sir Basil Blacket that the ratio of 1s. 6d., which he recommended, would avoid the necessity of raising the salaries of Government officials which a reversion to 1s. 4d. would call for. Sir Purshotamdas replied that a reversion to 1s. 4d. would, at the most, raise the cost of living by 12½ per cent, assuming that the wages had been adjusted to 1s. 6d. completely. The wages earned by the 3 classes of labourers, mentioned above, showed that they were in substantial excess over what they were in 1914 and thus

would leave a margin to cover this rise; on the other hand if the internal prices had not adjusted themselves completely to 1s. 6d., the rise in the cost of living, owing to the lower ratio of 1s. 4d., would not be so high as 12½ per cent.

Provincial Finance. With regard to the effects of 1s. 4d. on the provincial finance, Sir Parshottamdas pointed out that with the exception of the Madras Government no other Government had told the Commission of any apprehension. Even the ministers of the Madras Government had not shared these apprehensions. He reminded the members of the Indian Civil Service that when the recommendations of the Lee Commission were made, exchange was well below 1s. 4d. They would not be justified in claiming a higher pay in case the exchange was fixed at 1s. 4d., as the recommendations of the Lee Commission for an increase of their pay were based on an exchange which was not higher than 1s. 4d.

With regard to foreign trade it should be borne in mind that 1s. 6d. would amount to an indirect bounty on foreign traders; the Indians would pay Rs. 13-5-6 or a certain amount of commodities for which at 1s. 4d. they had paid Rs. 15; i.e., foreign articles would be cheaper by 12½ %. Industries which had been protected by tariff would require a further protection of 12½ %.

Sir Purshottam concluded: "For these reasons I am unable to accept the proposal to legalise 1s. 6d. as the new standard of money payments in India, and recommend, that the rupee should be stabilised at the rate which obtained for nearly 20 years, viz., 1s. 4d. to the rupee."*

* See Mr. Dalal's view, Chapter X, page 135.

Case for 1s. 4d.

Sir Purshottamdas recommended stabilisation of the rupee at 1s. 4d. He shared the widely held opinion that the standard of value of a country should never be changed unless it could be shown that circumstances had arisen, compelling such a change and that the old standard could not be maintained at all*. He held the view that if the Babington Smith Committee had not changed the ratio from 1s. 4d. to 2s. gold, it would have come back to 1s. 4d., as it did in 1924. With the ratio of 1s. 4d. on the statute book, there would have been no possibility of the pre-war parity being exceeded, as gold would have flowed in at that point.

Effects on the finance of the Government. The majority contended that 1s. 4d. as against 1s. 6d. would cause a heavy loss, as shown below, to the Government of India.

1. Revenue (in rupees):
 - (1) General Budget: 3·16 crores.
 - (2) Railway Budget: 1·01 crores.
2. Capital Expenditure:
 - (1) Railways: 1·68 crores.
 - (2) Postal and Telegraph: 2½ lacs.
 - (3) New Delhi: Rs. 63,000.

Of these the most serious was the loss involved in the general budget to the extent of 3·16 crores of rupees. The Railway budget was separated from the general budget for purposes of taxation except for the contribution which the Railway budget was to make to the general budget. Against this loss, Sir Purshotamdas pointed out, there would be an increase, in the first place, of 2·62 crores in customs on the stabilisation of the rupee at 1s. 4d.†

* See Note of Dissent by Sir Purshotamdas, page 135.

†The Same, page 136.

In the second place, there would be an increase in receipts under Income Tax "owing to industries being spared the disturbances incidental to 1s. 6d." Thirdly from general improvement in agriculture and trade, and the consequent increase of imports, he contended, that there would be additional income to the Government. Incidentally he pointed out that the fact that Sir Basil Blackett in his evidence before the Commission hoped an increase in revenue from 1s. 6d. would show that the adjustment to 1s. 6d. was still incomplete. Had the adjustment been complete, Sir Basil must have got all the benefits of a high exchange and would not have hoped for more in future.

Sir Basil also said in his evidence that in the long run it mattered little to the Government what the rate of exchange was. The alleged profit would accrue, as we know, only during the period of no-adjustment; when the adjustment would be complete, there would be no profit. Taking this statement into consideration, Sir Purshottamdas contended that the view that the de facto rate, if changed to a lower rate, would cause serious economic distress did not carry any weight. Sooner or later the period of non-adjustment would be over; and as soon as it would be over, it would matter little what the rate was. Further he contended that as the gain would last only during the period of non-adjustment, such a gain should not weigh much in fixing the rate of exchange. Lastly he pointed out that the gain to the Government would be at the expense of the producer "who has to accept fewer rupees for the produce he has to sell."

Effects on contracts. The effects of 1s. 4d. on contracts, he argued, would not be of a very serious nature. As far as commercial contracts, such as contracts to buy and sell goods, were concerned, exchange could

be covered for a period of 12 months ahead. Since 1924 it was widely known that the statutory rate of 2s. gold would be soon changed. Knowing this if a business man kept his contract open, he had himself alone to blame. The borrowing of industrial and commercial corporations which generally extend over a period of 20 or 30 years could not be affected by 1s. 4d. as such borrowings were incurred before 1917, i. e. at 1s. 4d. Only those who borrowed after 1917, i. e. at a time when exchange stood above 1s. 4d., would be affected. The number of such men, though not definitely known, could not be very large. Further Sir Purshottamdas pointed out that since 1917 exchange had at first fluctuated between 1s. 4d. and 1s. 10½d. and then between 1s. 3½d. to 1s. 6d. Under such circumstances borrowers must suffer some loss, no matter at which rate the exchange could be fixed.

The case of the Indian peasants would merit a careful consideration. Their agricultural debt in British India would amount, according to Mr. M. L. Darling, I. C. S., to 600 crores of rupees; to this must be added another 200 crores of rupees for the Indian states. Most of this debt was incurred, Sir Purshotamdas pointed out, between 1900 and 1917, i. e. at 1s. 4d. To raise the exchange to 1s. 6d. would be to increase their burden by 12½ per cent. The contract of this class of people, viz., the peasants, "ought to come in for full consideration in any decision to stabilise the rupee. Under the heading of contracts, therefore, the higher figure of 1s. 6d. has little to recommend it, and very much against it."

This was undoubtedly a very serious indictment against the proposal of stabilising the rupee at 1s. 6d. Mr. Madon in his very able work on "Exchange Fal-

lacies Exposed" assailed it on the same ground. He said that the twisting of the exchange from 1s. 4d. to 1s. 6d. would mean an increase in the burden on his land revenue and debts by 12½ per cent. Another charge of an equally serious nature was that the high exchange had mulcted the agriculturist to the extent of 12½ p.c. of the value of his entire produce and had seriously jeopardised his position. Mr. Madon calculated that the agriculturists had lost 40 to 45 crores in 1 year on some 360 crores of exports and another 40 to 45 crores in a year on account of the fall of internal prices.* Thirdly it was pointed out that a high exchange could hardly benefit the agriculturists by the cheapening of imports. These views were not considered by the Commission in spite of their serious and national importance. In reply to the first charge Sir J. C. Coyajee, a member of the Commission, pointed out that if 1s. 6d. had added to the agriculturists' burden of debt and revenue by 12½ per cent, it had also decreased his cost of living and production by the same percentage. The agriculturist, therefore, did not stand much to lose.† He also argued that if the agriculturist had to pay 12½ per cent more for their debts and revenue on account of a rise of the exchange to 1s. 6d., the critics had to admit that the rupee had appreciated by 12½ per cent. or, in other words, the rupee prices had adjusted themselves to 1s. 6d.‡ He met the second charge by referring to growth of agricultural capital. He says, "Now if the alleged great increase of the burden of debt and the material reduction of cultivator's income were positive facts, we would expect to see the following symptoms making their appearance without fail: (ā) the growth of the capital and deposit of the rural societies would

*India's Currency, Exchange and Banking Problems by Sir J. C. Coyajee pages 6 and 7.

†The Same, page 3.

‡The Same, page 3.

have been materially checked and even reduced; (b) proportion of arrears to outstandings would increase largely; (1) the rate of interest would rise remarkably and loans for unproductive purposes, like payment of debt, would increase materially. None of these symptoms were found; on the contrary the statistics of the Cooperative Societies of 1923-24 showed that capital had increased steadily and stood at Rs. 175 per member in September of that year; the working capital had also increased in the course of the year. There was also a similar increase in 1924-25. There was no rise at all in the rate of interest; on the other hand, during the year 1923-24 in the U. P., those Primary societies which had completed 10 years of working were allowed to borrow money from the Central Banks at reduced rates. Nor was there sign of any growth of loans for unproductive purposes.*

In answer to the third charge he quoted Sir P. C. Ray, the eminent scientist who was said to have made for years an intensive study of rural India by spending all his time in travelling through the districts and studying their conditions." In his evidence before the Royal Commission of Agriculture Sir P. C. Ray said, (this was quoted by Sir Jehangir), "owing to the increased price of jute there has certainly been a large 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 had a kind of fancy."† The value of such evidence, though it came from a personage whose bonafides no Indian can doubt, should not be exaggerated.

In Sir J. C. Coyajee's opinion, 1s. 6d. might increase the agriculturist's burden of debt by 12½

* Indian Currency, Exchange and Banking Problems by Sir J.C. Coyajee pages 4 and 5; Ratio Controversy, pages 49-61.

† India's Currency, Exchange and Banking Problems, page 201.

per cent: but this increase was only a partial set off against the earlier and much larger reduction of his debts. It is an undeniable fact that the real burden of the farmer's pre-war debts had been greatly reduced, since the purchasing power of the rupee was much lower in 1926 than it was in 1914. "For many years prices had been rising, with the result that all creditors had been losing and all debtors had 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".*

He further held that the influence of the change of ratio on the fortunes of the agriculturist was small and indirect. From 1924 to 1928 the Indian agriculturist, according to Sir Jehangir, had gained more than others owing to a rise in the price of agricultural products. The table below illustrates this.†

Periods.	Cereals	Pulses	Cotton manufactures.	Other raw manufactured articles.
1914	100	100	100	100
1915	115	122	97	128
1916	106	117	134	155
1917	92	96	203	183
1918	110	119	298	184
1919	163	180	295	192
1920	154	166	325	231
1921	145	160	280	242
1922	137	152	239	235
1923	114	112	221	207
1924	123	114	229	193
1925	136	128	210	165
1926	140	149	173	141
1927	139	155	159	151
1928	133	157	159	138

*Sir J. C. Coyajee, *India's Currency, Exchange and Banking Problems*, page 9.

†Sir J. C. Coyajee, *Ratio Controversy*, pages 49—61

The first thing we note is that the reaction to the inflated war-period prices of agricultural products was, in the case of India, later and less marked than elsewhere. Secondly the Indian agriculturist recovered in 1923 the ground he had lost; it was also at this time that the rupee exchange was also rising. During this period, as the table shows, the prices of the most important farm products went on rising, while, on the other hand, the prices of other commodities which the Indian agriculturist consumed began to fall.

We should now revert to Sir Purshottam's argument. In his opinion it would be more difficult to maintain 1s. 6d. than 1s. 4d., in case the balance of trade turned against India. Though it might be taken for granted that the Reserve was strong enough to maintain the high ratio at that time, it would be very difficult to do so in case of a failure of monsoon. He argued that a lower ratio would require smaller reserve than a higher one and, therefore, could be more easily maintained. "No one can say that the Government of India would not require larger reserve to maintain Exchange at 1s. 6d. than at 1s. 4d." In support of his views he cited the year 1926 when, owing to a "little lull" in the export trade, currency had to be deflated by 8 crores and an announcement was made to sell Reverse Drafts at 1s. 5³/₄d. Even if the Government would have reserves enough to maintain 1s. 6d., "Should not such a risk be minimised by adopting the lower ratio of 1s. 4d. which necessitated administrative support only during the period of extraordinary occurrence, not in India but abroad?" The first such decision arose in 1907 to 1910 due to an American crises. The second occasion was caused by the outbreak of the world war, from 1914-21.

He also pointed out that non-adjustment of prices to 1s. 6d. could not be invariably reflected in the foreign trade of India. The majority argued that if adjustments to 1s. 6d. rate had not taken place, "such a non-adjustment would have been reflected in the foreign trade of India and either exports or imports would be subjected to a handicap." The Indian peasants were poor; they could not hold out for a long time. Once the harvests were ready, they should have to be sold before the next, whatever the price might be, provided there was any demand for them. He also pointed out that in spite of four good years and lower prices for imports the Indian consumers had purchased as little imports as possible.

Sanctity of ratio. Finally Sir Parshottamdas emphasised the fact that a ratio that had been in force for 20 years had a sanctity which should not be violated. This standard was recommended by the Fowler Committee and functioned for a pretty long time till it was disturbed by a world upheaval. The attempt to maintain a new ratio in 1920 ended in a failure and loss to the tune of 35 crores of rupees. Further he asserted that "a change in the standard is bound to take away the confidence of the people, who will feel that they have been wronged by it, that it has been lightly changed and that it might be lightly changed again; for if a long established rate is deliberately changed, what is there to prevent another being made again at any time in future?"*

Criticism.

Gold bullion standard. The gold bullion standard, outlined above, was recommended by

*Note of Dissent by Sir Purshotamdas, para 149.

the Commission on the assumption that it would commend itself to the people, inspire their confidence in it and ultimately cure them of their uneconomic habit of hoarding. The Commission had also another object in view, viz., to guard against any possible loss or inconvenience that might arise in future from a rise in the value of silver. In recommending this standard, the Commission had clearly in view the English "Gold Standard Act of 1925" by virtue of which England returned to Gold standard, practically suspended since September, 1916, owing to the restriction on the export of gold. In doing so the Commission, we are constrained to say, erred grievously. We have been told at least a dozen times that "England is in matters of currency the worst possible model for India."* England had as late as 1914 a gold standard with a visible gold currency into which every kind of token currency was legally convertible. The people of England had handled a gold currency for years past, and naturally had great confidence in their currency authority. In education and other similar matters the British people are much more advanced than the Indians. What suits them may not suit us at all. And a Gold Bullion Standard had the least chance of carrying out the object it was intended to do. If the Gold Exchange Standard could not be and had not been understood by the people, they were not likely to understand the mechanism of the new standard. For internal purposes gold bars could not have any value as currency; they could only be hoarded or put to uneconomic use. Whenever people would require any gold, they would go to the bullion market and buy gold with their rupees. Unless people realise that they can use gold as

* Keynes, Indian Currency and Finance, Chapter II, page 15 and Chapter III, page 52.

currency, a gold standard can bring no change in the currency system of our country. The rupee would still remain for all internal purposes, the sole standard of value, practically unassociated with gold. Moreover the provision, that the Government should not sell gold bars of less than 1067 tolas in weight, was likely to make it altogether impossible for the people who are proverbially poor to realise the proposed change in our currency system. Even for unproductive purposes they could not buy gold from the Government.

Gold Currency. We must not be understood to suggest that a gold standard with a gold currency is the best standard. On the contrary gold standard has been regarded by many as a very defective one. Gold has nothing, as it has been said by an economic authority of unquestionable eminence, but the prestige of its smell*; and there is no justification, economic or social, for basing our social and material progress on the chance discovery of a gold mine. Man must have a better and more flexible method to base his currency system on. This view-point is unassailable from a purely economic conception. But man being what he is, not what he will be, his ideas and sentiments, his short sightedness and his conservatism, are to be taken into serious and anxious consideration in deciding what standard we should choose for currency arrangement. Most of the European countries returned to gold standard between 1925 to 1927 inspite of these considerations of weighty nature. The arguments adduced by the Commission against the adoption of a gold currency in India were based on expert evidence, and, as far as they went, were practically unassailable.

It must be, however, admitted, in fairness to the Commission, that a gold bullion standard can perform exactly the same functions and serve the same

*Keynes, A Tract on Monetary Reforms, Chap. IV, page 164.

purpose as a gold currency *provided it inspires the confidence of the people.* The inherent defects of the exchange standard in which silver rupee must always form the main currency and notes are legally convertible to rupees are, as stated already:—(1) The possibility of a rise in the value of silver and (2) the intricate nature of its mechanism unintelligible to the people. The only question was whether the new standard would be intelligible to the people and would inspire their confidence. And finally would it cure the people of the habit of hoarding? We are doubtful whether a gold bullion standard would be able, to inspire that confidence in it, which is so essential for curing the habit of hoarding. It is for this reason that such eminent authorities as Dr. Cannan and Dr. Gregory advocated the introduction of a gold currency into India.

The objections to gold currency have already been discussed. One objection was that in 1925 the proposal was very inopportune.* Admitting that the proposal was inopportune or untimely and that it would be expensive, we cannot get over the fact that only a gold currency can remedy the defects of the existing standard, particularly the psychological one.

Scheme for gold currency. The Commission had before them, besides the scheme of the Government, several other schemes for a gold currency in India. They were more or less based on the same principles and consequently similar in outlines, though differing in details. Dr. Gregory in his evidence before the Commission suggested that the introduction of a gold standard with a gold currency might not involve the

*J.C. Coyajee, *Currency, Exchange and Banking Problems*, page 33 and Chabiani, *Studies in Indian Currency and Exchange*, Chapter v, page 119.

immediate circulation of a large quantity of gold coins. He suggested that the gold coins should be unlimited legal tender and should circulate side by side with rupees, which along with other token currency should have their value maintained at par with gold. These token coins including rupees might not be convertible in the beginning into gold coins but should be limited in quantity and their place would be slowly occupied by gold coins with the expansion of trade. According to this scheme there would be no need of selling any silver, as silver rupees would remain unlimited legal tender and circulate as freely as gold coins. The evil effects of the sale of a large quantity of silver or silver hoards on silver markets and the consequent dislocation of trade which such a sale was likely to cause would thus be avoided. He also held that the introduction of a gold currency did not logically or practically involve the immediate circulation of large quantities of gold coins but only an extension of the use of gold in the future. Dr. Gregory, therefore, proposed:—

1. That the mints should be immediately opened for the coinage of gold coins in unlimited quantities.

The minimum denomination should be Rs. 20 until the inauguration of the full gold standard which should not be delayed for more than 5 years from the date of the opening of the mint to the coinage of gold. The new coin should be unlimited legal tender.

2. That the further coinage of rupees or issue of notes should be stopped from the date of the opening of the mint to the time, which was to be 5 years, when the new standard was to come into full force; and that so long as complete convertibility of the token currency into gold coins could not be introduced, silver or notes should only be given for gold within the limits of the actual existing circulation.

3. That of the 90 crores of rupees in the Paper Currency, only such portion should be sold as would be required for the encashment of Notes for Rs. 10 or under, the withdrawal of which was recommended by him.

The only objection to this scheme, apart from the general objections discussed above, is that it was likely to starve the Indian currency in order to make room for gold coins.*

*J. C. Coyajee, *India's Currency, Exchange and Banking Problems*, page 32.

Chapter XIV

Central Bank

Need for a Central Bank. The necessity of a Central Bank for India was felt as early as 1913. Writing in that year Mr. Keynes pointed out three defects of the Indian paper currency.* In the first place the function of note issue in India was dissociated from the function of banking. Notes were issued by the Government and bills were discounted by the banks. When more bills are presented for discounting, the natural conclusion is that trade requires more money. Where there are Central Banks with the right of note issue, they are usually able to increase their note-issue at such seasons of the year in order to discount more bills. This, we should remember, is a function which is of utmost importance and can only be performed by a Central Bank. In the second place there being no Government Banker, the Government kept the bulk of floating resources either in London or in cash in the treasuries.† This system, the independent Treasury system, meant that at a certain season of the year when taxes were flowing fastest into the treasuries, funds were withdrawn from the money-market. The United States had this independent Treasury system till September 1913. The difficulties experienced by the Government were so great, that in 1914 the Government established the Federal Reserve Bank which performs the same functions and is constituted on practically the same lines as the Central

* Indian Currency and Finance, pages 56 and 57.

† See Chapter VIII, pages 119-123.

Banks of Europe. The third defect was that the Indian currency was internally absolutely inelastic. We have seen the measures adopted to make it a little elastic. From these defects which still, to a very large extent, exist in the currency system, Mr. Keynes concluded; that they were due to "the absence of a State Bank."*

One of the most important recommendations of the Hilton Young Commission, which we will deal with now, was the establishment of a well-organised State Bank for India. From the evidence placed before them the Commission found that to remedy the defects inherent in the Indian Currency system the establishment of a State Bank was of essential importance. The Commission noticed the following defects:—

1. Currency and Credit were controlled by two distinct authorities whose policies might be widely divergent. Currency was controlled, as it is now, by the Government and credit, by the banks.

2. Currency and banking reserves were likewise controlled and managed separately from each other.

3. Another defect which the Commission noticed was the absence of a well-organised credit system, which should enable the various commercial banks, whenever necessary, to turn their assets into cash without any disturbance to general conditions. A Central Bank could afford only such facilities by the system of discounting.

The importance of a Central Bank had received a striking proof in the fact that every great nation had thought it proper and advantageous to have it in one shape or another. The only country which had not one

* Keynes, *Indian Currency and Finance*, pages 56-58.

Central Bank for a long time was the United States which, owing to the absence of such a bank, experienced recurring financial crises.

The main functions of a Central Bank are to issue notes and maintain the stability of the currency. They hold the currency and banking reserves and the cash balances of their Governments and confine their business to that of a bank of the banks and of the Government. They carry on their business on very sound lines and do not transact the ordinary banking business; in times of crisis they help the other banks with credit facilities and generally guide the financial policy of the Government.

Name, Capital and Composition of the Bank. To carry on this business the Commission strongly recommended the establishment of a new bank on the lines suggested above. It was suggested that, instead of having a new bank, the Imperial Bank might be entrusted with these functions. The Commission, however, found that the Imperial Bank, with its many branches, had afforded great banking facilities to the people and had been fostering in them the habit of banking and investment. It was thought highly inadvisable by the Commission to impair the usefulness of such a bank by limiting its activities. On the contrary the Commission suggested the removal of those restrictions which were imposed on it to enable it to carry on a part of the functions of a Central Bank. With a full-fledged Central Bank in the country the Imperial Bank could be safely freed of its restrictions and allowed to extend its useful activities all over the country. Another proposal of the same nature was made to the Commission. It was proposed that the function of the Central Bank might be entrusted to the Imperial

Bank in those places only where there were adequate banking facilities; in other places it would carry on its ordinary business. The Commission could not find their way to accept this proposal as, in their opinion, under these circumstances its commercial activities would cease to operate in such important places as Calcutta, Bombay and Madras where they were badly required and its hybrid character would weaken its functions both as a central bank in the important centres and as a commercial bank in the smaller areas. These considerations weighed with the Commission who decided that a new bank with a new charter should be entrusted with the functions of a Central Bank.

Capital of the Bank. The Commission held that a Central Bank would not require a large capital, at least, to start with. Moreover a large capital for a Central Bank with strictly limited activities had its dangers. In the opinion of the Commission "the greater the capital, the greater must be the profits in order to produce a given return and the greater, therefore, the incentive for the management to do business which it might be better to avoid." There was another reason for such a recommendation. The Central Bank would be required to pay, according to the proposal of the Commission, a share of its profits to the Government after deducting from the profits a fixed dividend for the shareholders. A large capital in such a case, pointed out the Commission, would result in a loss to the Government, as the major part of the profits should have to be reserved for the shareholders. Taking these views into account the Commission thought that a fully paid-up capital of Rs. 5 crores would be sufficient. As the Central Bank would take over some of the duties of the Imperial Bank, it was proposed that the shareholders of the Imperial Bank should be given the first opportunity to subscribe to the capital of

the Central Bank which should be called the " Reserve Bank of India."

Board and Management. The head office of the new bank should be established at Bombay where ordinarily the meetings of the Central Board should be held. There would be three local head offices, viz., at Calcutta, Bombay and Madras managed by local Boards who would be elected by the shareholders registered in their respective branch registers. Each local board should have a President and a Vice-President, both of whom would be elected for a period of two years. The Central Board at Bombay should consist of (1) the Presidents and the Vice-Presidents of all the local Boards and one elected member from each ; (2) of a Managing Director and a Deputy Managing Director who should be men of experience and whole-time officers, appointed by the Governor-General in Council for 5 years on salaries and allowances fixed by the Central Board and (3) of some other members, not exceeding 3, to be nominated by the Government. Over and above these 14 members, the Government could appoint one member who should attend and advise the Board but should not vote. The underlying idea of this provision was to free the Board from every kind of executive interference. It was also proposed that no member of a legislative council should be appointed President or Vice-President of a local Board or a member of the Central Board.

Votes of the Shareholders. As the policy of the Reserve Bank should be dictated by purely national considerations, the Commission suggested that provisions should be made in the Charter that no section of the community might have a preponderent influence over its decision. No shareholder should have more than ten votes, whether in his own name or as proxy; a shareholder could have only one vote for every four shares that he would hold.

Profits. The Reserve Bank, in the opinion of the Commission, should not be run mainly for profits. It was suggested that dividends should be limited to a reasonable return on its capital; that adequate provisions should be made to build up substantial reserves and that the Government of India should be compensated for the loss they would suffer in handing over to the Bank their reserves and also the profits from the right of note-issue. The Commission laid down that after making provisions for bad and doubtful debts, depreciation in assets and all such items as were usually provided for by bankers, the Reserve Bank, after paying out of the net profits a cumulative dividend of 5 per cent per annum on the paid-up capital, should allocate three-quarters of the surplus to the reserve fund until such fund would amount to 25 per cent of the paid-up capital and one quarter to the Government. After the reserve fund had reached 25 per cent of the paid-up capital, the Bank should contribute half of the surplus to the reserve fund and the other half to the Government. When the reserve fund would be equal to the paid-up capital, one-eighth of the surplus, not exceeding 3 per cent of the paid-up capital, should be paid to the shareholders and the balance to the Government.

Business of the Bank

The Bank should be authorised, in the opinion of the Commission, to transact the following kinds of business:—

1. It might make and issue Bank notes.
2. It might accept money on deposit on current account from, and collect money for, the Government of India, Provincial Governments, banks and bankers.

3. (a) It might buy, sell, or rediscount bills of exchange, promissory notes, or other commercial paper of *bona fide* nature, bearing two or more good signatures, one of which must be that of a bank or banker and having a maturity of not more than 90 days.

(b) It might sell, buy or rediscount, to an amount not exceeding 20 per cent of its total discounts bills of exchange, etc., bearing two or more good signatures, one of which must be that of a bank or banker, drawn or issued in respect of current transactions for agricultural purposes with a maturity not exceeding six months.

(c) It might buy, sell or rediscount bills of exchange and promissory notes with a maturity of not more than 90 days, issued or drawn for the purpose of carrying or trading in Government of India securities.

(d) It might buy and sell securities of the Government of India or of a Provincial Government or a local authority in India, having not more than 6 months to run, upto a certain extent.

4. It might make loans for fixed periods not exceeding 90 days against certain specified kinds of securities.

5. It might advance money to the Government of India for ways and means purposes.

6. It might buy and sell to banks and other bodies approved by the Central Board of the bank, transfers by telegrams or letter, sight drafts, etc., drawn in or on countries with the gold or gold exchange standard.

7. It might invest a sum, not exceeding its paid-

up capital and reserve, in securities of the Government of India or of other Governments, having not more than 5 years to run.

The Commission also laid down that the Reserve Bank should not be allowed to carry on certain classes of business. The entire scheme was drawn up on the basis of two principles, viz., (1) that the Bank should be a true Central Bank and (2) that its functions as a Banker's Bank might be performed without jealousy*.

Remittances

The Bank should be entrusted, laid down the Commission, with all the remittance operations of the Government in India as well as in London. The Government accordingly would cease to operate directly in the exchange market. This recommendation was made because it was thought, in the first place that the business of remittance was essentially a banking business. In the second place, as the Bank would be required to maintain the value of the internal currency, it would be difficult for it to discharge this obligation "unless it conducted the remittance business of the Government". The annual remittance to London amounted to, on an average, £ 35 millions; the time and method of making this remittance had an intimate connection with the Bank's discharge of its obligation. The Commission also stressed the advisability of furnishing the Bank periodical information as to the requirements of the Secretary of State for India. Such information would come through the Government of India. The Commission admitted that it would not be always possible to forecast with accuracy the requirements of the Secretary for any considerable length of time ahead. It was likely that on occasions

* See Schedule II, Report of the Hilton Young Commission.

the estimate given to the Bank might fall short of actual requirements. But such occasions would be very few. Moreover as the Secretary of State would always have funds at his disposal, he would not experience any serious difficulty on this score.

As regards the method of remittance the Commission held that the Bank might choose any method it would think proper and convenient. They noticed that for some time past remittance had been made by the purchase of sterling in India and not by the sale of Council Bills in London. This method had been successfully adopted. The Commission, however, observed that such purchase should be made in open market at competitive rates.

Primary Function of the Bank

The primary function of the Bank, the Commission pointed out, would be to maintain the stability of the purchasing power of the monetary unit of the country, *i. e.*, of the rupee, both internally and externally. To achieve this object two things would be necessary. Firstly internal price-level should remain stable. Secondly the external price of the rupee, *i. e.*, exchange, should remain stable in relation to gold. The Commission observed that there was a close relation between internal and external stability of the purchasing power of the rupee. Internal stability of prices could be maintained by timely and adequate contraction or expansion of the Currency in accordance with the requirements of trade. "So long as the volume of the monetary circulation does not exceed, or fall short of, the amount of money, at any time needed for the exchange of the quantity of goods and services which have to be exchanged, the purchasing power of the rupee would remain stable. The restriction of the monetary circulation within these limits is the funda-

mental condition of internal stability, while internal stability is the main factor to achieve external stability.”*

It is easy to understand how internal stability of prices influences the exchange stability. If the internal prices rise, *i. e.*, the purchasing power of the rupee falls relative to the world level of gold prices, exports will decrease and imports will increase, and this will cause the balance of foreign payment to be upset and with it, the exchange. Similarly if the internal prices fall in relation to gold prices, exports will increase and imports will decrease upsetting the exchange. In the former case with large imports there will be a heavier demand for gold than for silver; silver will fall in value in relation to gold and exchange will fall. In the latter case, owing to excess of exports over imports, there will be a greater demand for rupees than gold; the exchange will rise. To assure exchange stability it is indispensable that an obligation should be put on the Bank at all times to buy and sell gold at fixed prices. “It clearly follows that stability of internal prices in relation to the world level of gold prices will prevent these repercussions and will, therefore, prevent instability of the external value of the monetary unit, that is, of the exchanges.”

Such a stability in the internal and external purchasing power of the rupee could be maintained, the Commission claimed, by entrusting to the Bank the (1) sole right of note-issue, (2) the stoppage of all further issues of money by the Government of India except through the Bank and by (3) a judicious credit policy; in other words, the Bank, to carry out its work, should have complete control over the volume of monetary circulation.†

* Hilton Young Commission, para, 115.

† See Chapter XV, Stability of prices is stability of exchange.

Note-issue

Fixed Fiduciary System. The principle of note-issue may be either based on (1) the fixed fiduciary system as enunciated by the Bank Charter Act of 1844, or (2) on the proportional reserve system as it obtains in many of the countries of Europe, in the United States under the Federal Reserve System and in South Africa. The underlying principle of the fixed fiduciary system, as we have explained already, is that upto a certain limit fixed by statute, notes can be issued against securities. Any additional notes, over and above this fixed fiduciary portion, can be issued only against a gold backing of 100 per cent. The defect of this system is its inelasticity. If more currency is needed (as, for instance, in a severe crisis), nothing remains but to suspend the Bank Charter Act. Under such a scheme the expansion or contraction of the note-issue beyond the fixed fiduciary portion can take place at a rate exactly corresponding to the increase or decrease of the gold reserves.

Proportional Reserve System. According to this system the notes in circulation are secured by a minimum percentage of gold or gold securities, fixed by statute. Thus in the case of the Federal Reserve System and South Africa the minimum percentage is fixed at 40 percent of the notes in circulation, *i. e.*, if 200 notes are in circulation, 80 of them will be secured against gold and the rest, *i. e.*, 120, against securities. These minima are not rigidly fixed but can be increased with the consent of the Government for short periods, provided the banks pay a tax on the amount of the deficiency. Its chief characteristic is that it is more elastic than the other system as contraction and expansion do not take place at the same rate as the gold reserves increase or decrease; contraction

or expansion takes place here in the proportion of 100 : 40. If an addition of 40 units of gold is made to the reserve, the note-issue would increase not by 40 units as in the fiduciary system but by 100 units. Conversely a loss of 40 units forces a contraction to the extent 100 units. "This system thus permits of a far wider range of expansion and contraction than the fixed fiduciary system".

In the light of these considerations the Commission recommended the proportional reserve system for India and laid down that the percentage of gold and gold securities in the reserve should not be less than 40 per cent of the liabilities, i. e., of the note, plus 50 crores on account of outstanding rupees. The Commission, however, hoped that the Banks in normal times, should have a much higher percentage than 40 per cent minimum.

Bank's right to note-issue. The Bank should have the sole right to issue bank-notes for a period of, say, about 25 years. The notes issued by the Government should cease to be legal tender, except in Government treasuries, in five years from the date of the charter creating the new Bank would become operative. The notes should be issued by the "Issue Department" which should be kept separate from the "Banking Department of the Reserve Bank." The liabilities of the "Issue Department" should be equal to the amount of Government of India and Bank notes in the issue department plus 50 crores for the redemption of rupees. The notes of the Bank shall be legal tender for the payment of any amount and should be guaranteed by the Government. This guarantee, it was believed, would create confidence in the new notes which would differ in two important points from the notes issued by the Government. In the

first place they would be issued by the Bank; in the second place, they could be converted, as a matter of right, into gold bars and not into rupees as hitherto. These changes might discredit the new notes; and, to avoid such a possibility, the Commission thought, they should be guaranteed by the Government. The new notes, it is very important for us to bear in mind, could be legally converted into gold bars only. This is the essence of the Gold Bullion Standard. The notes could be converted into rupees but *only at the option of the Bank*. The Commission, however, recommended that the Bank should supply freely silver rupees to the people. The notes might be of the following denominations:— 1,5,10,50,100, 500,1000 and 10,000 rupees.

Buying and Selling of Gold

We have noticed that the essence of gold standard or gold bullion standard is to link to gold effectively the currency of the country, i.e., the internal currency should be convertible, freely and to any amount, into gold. The Commission, therefore, laid down that the Bank should sell gold to any person who would require gold and apply for that purpose to its offices at Calcutta, Bombay or Madras; such gold should be sold only in bars of 400 ounces (1,065 tolas) of fine gold at the price of Rs. 21-3-10 per tola, provided that whenever the market rate for the selling price of telegraphic transfers on London would be less than upper gold point of the exchange, the Bank should sell gold as aforesaid for delivery at its office at Bombay or in London at the option of the purchasers at prices called the 'notified prices.'

The upper gold point should be equivalent to 1s. 6d. gold plus a proportionate amount to cover the cost of shipping gold bullion from London to Bombay

including packing, freight, insurance and loss of interest. The "notified price" for delivery in London should be Rs. 21-3-10 pies per tola plus the cost of shipping as explained above. The notified price for delivery in Bombay should be the same price plus an amount corresponding to twice the said expenses.

Similarly the Bank should be under a statutory obligation to buy gold bullion for delivery at its Bombay office at the same price in the forms of bars containing 400 ozs. (10,65 tolas) of fine gold.

Reserve

The only other point which we would refer to is the new Reserve. The Commission laid down that the 'Issue Department' would have 40 per cent of its reserves in gold and gold securities. Of its gold coin or gold bullion at least one-half should be kept in the Bank's custody and the rest might be held outside India. Out of 40 per cent of gold and gold securities in the reserve, gold bullion and gold coin should not be less than 20 per cent of the liabilities after the end of the 5th year and 25 per cent at the end of the 10th year from the date of the charter becoming operative. The balance might be kept in rupee coins, Government of India rupee securities and such domestic drafts, bills of exchange etc. as the Bank would be authorised to purchase under the charter, provided the rupee coins might not exceed a certain limit prescribed by the Commission or 10 per cent. of the liabilities of the Issue Department.

Other minor Recommendations

Among the other recommendations one was that the Banking Department should be separated from the Issue Department. The second was that the Bank should maintain the free interchange ability

of the different forms of legal tender currency. It should issue notes on demand in exchange for rupees, and notes of lower value or rupees or other token coins in exchange for notes of Rs. 5 or upwards. The Government should supply silver rupees or token coins to the Bank on demand; if, however, the Government would fail to discharge this duty, the Bank would be released from its obligation to supply such coins to the public. Further the Bank should be authorised, subject to the consent of the Governor-General in Council, to suspend for 30 days and to renew such suspension for 15 days, the requirements as to gold and gold securities reserve specified in the charter. But on such occasions the Bank should be required to pay a tax on the amount by which the reserve would fall below the requirements laid down by the charter.

Chapter XV

1927 to 1931

Currency Bill

The main recommendations of the Hilton Young Commission were accepted by the Government of India which embodied them in two bills, *viz.*, the Currency Bill and the Gold Standard and Reserve Bank of India Bill, and placed them before the Legislative Assembly for discussion and approval. They called forth a heated debate and raised a fierce controversy all over the country. The object of the Currency Bill was to give effect to those recommendations of the Commission, which were intended to stabilise the rupee at a fixed parity *with gold*. The Bill (1) fixed the gold value of the rupee at 1s. 6d. (gold), (2) imposed an obligation on the Government to buy gold bullion at the rate of Rs. 21-3-10 pies per tola of fine gold in the form of gold bars containing approximately 40 tolas and (3) to sell *at their option either gold or gold exchange* at an equivalent rate payable in gold standard countries outside India at the gold points, provided that no person should be entitled to demand any amount of gold or sterling of less value than that of four hundred fine ounces (1065 tolas). (4) It also proposed to remove the legal tender character of the British Sovereign and half-sovereign, though such coins were to be received at Government Offices or Treasuries at the rate of 1s. 6d. gold per rupee.

A heated controversy raged round the ratio question, a controversy which is still alive. An over-

whelming majority of persons supported the dissenting member, Sir Purshotamdas, and claimed that 1s. 4d. would be the best and most justifiable ratio. As the voice of controversy is still heard and the arguments adduced by the parties raised some questions of more than passing importance we shall refer to them here briefly; some of them have been discussed fully in the preceding chapter.

Sir Basil Blackett, the Finance Member of the Viceroy's Executive Council, in sponsoring the bill employed all the arguments of the Commission. The popular leaders favoured 1s. 4d. and vehemently opposed 1s. 6d. We have set forth in detail the arguments of the Commission who recommended 1s. 6d.; we have also analysed critically the points raised by Sir Purshotamdas in his minute of dissent against stabilising the rupee at 1s. 6d. He preferred 1s. 4d. The popular leaders in the Legislative Assembly and outside it supported Sir Purshotam and carried on a vigorous propaganda in favour of 1s. 4d. We shall note here some of their arguments as they deserve careful study.

1. The first argument against 1s. 6d. and in favour of 1s. 4d. was that the higher ratio would seriously injure the foreign trade of the country. This proposition was placed before the Herschell Committee and received their careful consideration.

This is an old argument. We have seen that the alleged stimulus to imports and check on exports from a rise in exchange is only temporary; it can last only so long as wages and other factors of production do not fall in response to the rising exchange. This is only one aspect. In the interval, *i. e.*, during the period of maladjustment, there is likely to be dislocation of business; export trade will tend to fall off

and imports may increase. But the more important point is that neither a rising nor falling exchange necessarily brings about the results which it is supposed to do. The Herschell Committee had this view placed before them and held, as we have seen in a previous chapter that the statistics of export and import trade did not support it.* This finding of the Committee was again confirmed in 1921 to 1924. The sterling and the gold value of the rupee began to rise from 1921†; but neither the imports nor the exports showed the tendencies associated with a rising exchange. The table below illustrates the statement :

Years	Exports (Private) (In lakhs of rupees).	Imports (Private) (In lakhs of rupees).
1921-22	245,44	266,34
1922-23	314,32	224,31
1923-24	361,91	217,03
1924-25	398,17	243,16
1925-26	385,15	224,11

The table shows that the exports kept on rising steadily from 1921-22 to 1924-25 and the imports during the period fell considerably. During this period exchange rose from 1s. $1\frac{25}{32}$ d. (gold) in January, 1922 to

1s. $5\frac{3}{16}$ d. gold in December 1924. This increase in exports we may note, in passing, was mainly attributed partly to an increased demand for such Indian products as cotton, jute and tea by the outside world and partly to good harvests which lowered the prices of rice, cotton, wheat, etc., and increased the demand for them.

Again from January 1925 to December 1926 both the sterling and the gold value of the rupee remained

* See Chapter IV, page 46, and Chapter V, page 73.

† See pages 205 and 206.

the same; but both the exports and imports of private merchandise were greater in 1924-25 than in the preceding year and lower in 1925-26 than in 1924-25. The statistics of trade, (both export and import) from 1924-25 to 1930-31 once again confirm the finding of the Committee.

(In lakhs of rupees).

	Exports	Imports	Balance
Average of the 5 pre-war years ending 1913-14	224,12	145,85	78,27
Average of the 5 years from 1914 to 1918-19	224,14	147,80	76,34
Average of the 5 first years ending 1923-24	301,30	248,81	52,49
1924-25	398,17	243,16	155,01
1925-26	385,77	224,11	161,24
1926-27	309,45	229,98	79,47
1927-28	328,69	246,73	81,96
1928-29	337,96	251,42	86,48
1929-30	317,93	238,91	79,02

These figures show that in every year since 1925-26 the exports of merchandise were greater than the average of the 5 pre-war years ending 1913-14 and the average of the five post-war years ending 1923-24. Looking at the imports we notice that they were less in 1925-26 by 19.05 crores than those of 1923-24 against a drop in exports by only 12.82 crores and lower than the average of the 5 years ending 1923-24 by 18.83 crores. The balance of trade went on increasing from 1926-27 to 1929-30. These figures

therefore do not support the theory. It is of doubtful value.

2. The second argument which carried much weight at the time was that the agriculturists who formed about 80 per cent of the total population of India would lose heavily both as producers and debtors as a result of the rise in exchange. The general conditions of the cultivators which we have noticed in the preceding chapter did not prove that they had been hit hard by the rise in exchange; on the contrary they seemed to have improved their conditions. As producers they stood to lose; but the amount of such loss and its nature must be clearly understood. Here is a little fallacy against which we should do well to guard ourselves.

From a fall or rise in the exchange the agriculturists are likely to gain or lose only when there is a rise or fall in prices. Unless, therefore, a rise in exchange has brought about a fall in prices, they are not likely to lose as sellers; nor can the burden of land revenue they pay increase. It should not be assumed also that high prices are a source of real prosperity to the entire population. Apart from their injurious effects on the wage earners whom in our enthusiasm for the agriculturists and other producers we neglect often, they do not benefit all the agriculturists as a whole.

In the first place there are the numerous field labourers and farm servants whose number was estimated at nearly 4 crores (38 millions) in 1921. They stood to gain by a fall in prices and lose by a rise in prices.* Among the actual cultivators there are, however, many who are not likely to suffer any loss from a fall in prices (*i. e.* high exchange); they are

* See Chapter X, page 153.

those who have little or no surplus to sell and consume generally all that they produce; they are not affected by a fall in prices. Even those who have a surplus to sell make good a part of their loss by the fall in prices; they pay less as consumers for various articles they buy, and the money they save possesses a greater purchasing power than before. It must be admitted, however, that those agriculturists whose land revenue was settled during 1917-24 when the prices were higher than they were in 1927 and in subsequent years have suffered as tax-payers by the fall in prices. They are suffering very heavily now as the prices have fallen very low. If prices do not rise to the level of the period when the revenue was assessed, equity and fairness demand a revision of the assessment.

We have already referred to some of the points raised by Sir Purshotam in his note of dissent; we will discuss the others. One of his contentions was that the Government could have stabilised the rupee at 1s. 4d. gold in September, 1924, thus restoring the long established legal standard if they had chosen to do so. The rupee reached its pre-war parity, *i. e.*, 1s. 4d. (gold) in September, 1924.* Sir J. C. Coyajee refuted this contention. He held that it would have been too early and too hazardous to attempt to stabilise the rupee in 1923-24. One of the pre-requisites for the stabilization of the rupee was budgetary balance which was not reached until the year 1923-24 when a start was made with a surplus of 2 crores. The stabilisation of our currency and exchange, according to Sir J. C. Coyajee, is an international problem and one of the main considerations in determining whether the time had arrived for taking such a step was the possibility of making any estimate of the future course of world

* See Chapter XIII, page 247.

prices and monetary policies. In 1924 prices were fluctuating in England and America, and the currency policies of some of the important countries were in a state of flux.*

Further it was pointed out that an attempt on the part of the Government to stabilise the rupee at 1s. 4d. in September 1924 would have required a considerable inflation of the currency. In that month the index number of prices in the United States stood at 149, that of Calcutta at 175 and that of Bombay at 181. In August, 1926 and September, 1927, the index number stood again at 149 in the United States; the index number in Calcutta in these two months was 147 and 149 respectively and in Bombay it was 148.

The rate of exchange was 1s. 5 $\frac{31}{32}$ d. gold in August 1926, and 1s. 5 $\frac{15}{16}$ d. gold in September 1927. If the normal rate of exchange was 1s. 4d. (gold) in 1924, as determined by relative price-levels, prices in August 1926 had to be raised by 33 points in the Bombay index number and 28 points in the Calcutta index number in order to bring the normal rate of exchange to 1s. 4d.; this could have been done only by a policy of heavy inflation.†

With regard to the argument that the Government manipulated the exchange, *i. e.* kept it in the neighbourhood of 1s. 6d. from 1925 by a policy of deflation and contraction of currency, it was pointed out that "not only is the actual deflation exaggerated but the efficiency of monetary deflation as a factor in monetary stabilisation is unduly magnified."‡ According to Sir Purshotamdas the average pre-war annual expansion of currency in India was 20 crores of

* Sir J. C. Coyajee, *Ratio Controversy*, pages 13-20.

† Chablani, *Studies in Indian Currency and Exchange*, Chapter VII, pages 211-12.

‡ Sir J. C. Coyajee, *Ratio Controversy*, pages 20-23.

rupees, while the average annual expansion during 1921-22 to 1924-25 was only 11·12 crores. Coming to details we note that the total deflation in 1920-21 amounted to 31 crores and 58 lakhs; in 1921-22 and 1922-23 it amounted to 6 crores and 80 lakhs. Sir J. C. Coyajee argued that this "contraction was nothing like the drastic deflation which took place in Great Britain in 1920-21 which halved prices. During the period 1914 to 1919 the rupee circulation rose from 187 crores to 280 crores and the note circulation from 61 crores to 183 crores. "As compared with this huge inflation the deflation could not be said to be drastic."*

There can not be a normal rate either of deflation or inflation; both depend on the exigencies of time. The rate of inflation necessary at the time of rising prices may not be necessary at a time when prices are falling. The influence of contraction of currency on exchange and prices is often exaggerated. The rise of the exchange in 1898 to 1s. 4d. was due, we have seen in a previous chapter, to various causes, only one of which was the contraction of currency. It would be too hasty to assume that by a contraction of currency it is always possible to maintain the exchange at a high level.†

The crux of the controversy was, however, as noticed already, whether prices and wages had adjusted themselves to 1s. 6d. This was a question which was so complicated and involved so many nice calculations that it did not admit of a definite answer. The views of the majority of the Commissioners and of the dissenting member have been set forth in detail in the previous chapter. We should note one point only, a point which was not stressed by Sir Purshotamdas and

* Sir J. C. Coyajee, Ratio Controversy, pages 23-29.

† Sir J. C. Coyajee, the same.

which the majority declined to accept. In the opinion of some of the witnesses, most competent to pronounce a judgment on the matters before them, the year 1926 was too early for taking any step to stabilise the rupee. The stabilisation of the rupee was based on the assumption, which turned out to be wrong, that in 1927 there was better prospect of a relative stability in world prices than there had been at any earlier time. But prices continued to fall from 1926 and were as unstable in that year, as before, as the table below shows.

Year.		Calcutta (Indian Trade Journal) 1914-100	Bombay (Bombay Labour Gazette) 1914-100	United Kingdom (Board of Trade) 1914-100	United States (Board of Labour statistics. 1926-100)
1915	annual average	112	...	...	70
1916	"	128	...	...	86
1917	"	145	...	...	118
1918	"	178	239	...	131
1919	"	196	223	...	139
1920	"	201	216	...	154
1921	"	178	198	307	98
1922	"	176	187	197	97
1923	"	172	181	159	161
1924	"	173	182	159	98
1925	"	159	163	166	104
1926	"	148	149	159	100
1927	"	148	147	148	95
1928	"	145	145	141	98
1928	April	146	142	143	97
"	May	147	145	144	99
"	June	145	149	143	98
"	July	148	147	141	98
"	August	143	146	139	99
"	September	142	148	138	100
"	October	143	150	138	98
"	November	146	149	138	97
"	December	145	147	138	97
1929	January	145	148	138	97
"	February	144	150	138	97
"	March	143	147	140	98
1929	annual average	141	145	137	97

Year.	Calcutta (India Trade Journal) 1914-100	Bombay (Bombay Labour Gazette) 1914-100	United Kingdom (Board of Trade) 1914-100	United States Board of Labour statistics 1926-100
„ April	140	144	139	97
„ May	139	141	136	96
„ June	138	143	136	96
„ July	142	145	137	98
„ August	143	146	136	98
„ September	143	147	136	98
„ October	140	146	136	96
„ November	137	143	134	94
„ December	139	141	133	94
1930 January	131	139	131	93
„ February	126	137	128	92
„ March	125	137	125	91

The prices are still falling and have rendered the situation more critical than ever. This fall in prices was predicted by some of the eminent authorities who deposed before the Commission. It was the well-considered opinion of economists of the standing and reputation of Mr. Keynes, Sir Charles Addis and others that no attempt should be made in 1926 to fix the exchange which should be allowed to take its own course "until the reconstruction of the economic life of Europe permits of some sort of reasonable estimate being taken of the future course of world prices."*

There was little justification for the Commission, in face of these warnings, to recommend stabilisation of the exchange in 1926 when the possibility of a fall in prices was clearly visible; but the Government of

* Hilton Young Commission, Minutes of Evidence, question 13724, 13728, 12981 & 13005.

India erred more seriously in taking steps to stabilise the rupee at a time (*i. e.* 1927) when prices were falling and showed a tendency to fall further in near future. The two parties looked at the question from two different view-points. The Government insisted on fixing the ratio at 1s. 6d. and succeeded in doing so, we need not wonder at the success, as a high exchange would make the task of framing the budget much easier. The popular leaders and the Currency League, formed at this time to popularise 1s. 4d., demanded a lower exchange which was sure to raise prices and was beneficial to the producers. The Currency League looked at the question from the view-point of the manufacturers who gain from rising prices and lose from falling prices. Amidst the heat and smoke that rose from the controversy, it became difficult either for the Government or for their critics to see through things and realise that they advocated and fought for a wrong issue; the proper course would have been as advised by such eminent economists as Mr. Keynes and Prof. Gustav Cassel, to leave the exchange to take its own course and try to stabilise internal prices only.

Stability of prices vs.

Stability of Exchange.

The foregoing discussion leads us on to the question whether stability of exchange is to be preferred to stability of prices. Stability of exchange can only be secured in case the internal and the external price-level remains stable. The purchasing power parity, explained in Chapter I, requires a little more amplification to bring out its full significance and to explain how stability of exchange can be secured by internal and external stability of price-level. This doctrine, when analysed, runs as follows:—

1. The purchasing power of an inconvertible currency within its own country depends on the amount of the currency in circulation and on the currency habits of the people.

2. The purchasing power of an inconvertible currency *in a foreign country* is the rate of exchange between this currency and the foreign currency, multiplied by the foreign currency's purchasing power in its own country.

3. In conditions of equilibrium the internal and the external purchasing power of a currency must be the same. This is easy to understand; if the internal purchasing power is less than the external power, prices will be high at home and low abroad. Imports will increase and exports will decrease; money will flow out till the prices at home and abroad come near each other.

4. It follows from the above that the rate of exchange between the home-currency and the foreign currency must tend, in conditions of equilibrium, to be the ratio between the purchasing powers of the home-currency at home and of the foreign currency in the foreign country. This ratio is the purchasing power parity.

If, therefore, the internal and the external purchasing powers of the home currency are different, the actual exchange rates will differ from the purchasing power parity.

The rate of exchange between the currencies of two countries depend on the relation between internal price-level and external price-level. If prices, both internal and external, are unstable, there cannot be any stability of exchange. The external prices generally cannot be controlled by one country, as prices

in each country depend on the currency policy of the Government and the currency habits of the people. In these circumstances a country is to submit either to its own price-level or to exchange being pulled about by external influences. "If external price-level is unstable we cannot keep both our own price-level and exchange stable. We are to choose".* What is a country to do? The right choice, in the words of Mr. Keynes, is not necessarily the same for all countries; it depends on the nature and comparative importance of the foreign trade of the country. If the foreign trade of a country is larger in amount than the internal trade, stability of exchange is more important than stability of prices. On the other hand if the internal trade is larger in volume than foreign trade, stability of prices is more desirable than stability of exchange. We should note the advantages and disadvantages of each. Stability of exchange, let us remember, is helpful only to those who carry on foreign trade; stability of prices, on the other hand, prevents those violent disturbances which are associated with unstable prices. A fluctuating price-level disturbs the whole economic structure of a society, it creates uneasiness in the minds of the people, causes loss of confidence in the future trend of affairs and sets one class, against the other. Thus rising prices act as a stimulus to enterprise and is beneficial to business class; but causes injustice to wage earners and to investors. Falling prices hit business, create unemployment and do injustice to borrowers. It is difficult to decide which of the two is worse. Both are bad, and, if possible, should be avoided. But these considerations point to the conclusion that

* This argument is a summary of Mr. Keynes' view; See his Monetary Reform, Chapter III pages 76 to 106 and Chapter IV, pages 154 to 156.

stability of prices is better than stability of exchange, provided the task is feasible. Finally we should note that in the recent economic history of India such a task was undertaken, more by chance than by design, and was carried out successfully. During 1919-20 when prices were rising, the rupee could not be maintained at its old parity with gold; it was allowed to rise in value and rose considerably above its old exchange value according to the natural law of demand and supply. The result was that the Indian Index Number of price-level in 1920 rose only by per cent, the average figure of 1919; while in England 12 it rose by 29 per cent. Again when in 1921 the world prices began to fall, the rupee was also allowed to fall, with the result that the lowest point touched by the Indian Index Number in 1921 was only 16 per cent below the highest in 1920, whereas for England the figure was 50 per cent. In fact India experienced less disturbance in prices from 1919 to 1925 when exchange was let alone than any other country.

Gold Bullion Exchange Standard

The Bill was, however, passed and came into force on April 1, 1927. It will be observed that the provisions of the Act, known as the Currency Act of 1927, differed materially from the recommendations of the Commission. They recommended a "Gold Bullion Standard"; but the Government abandoned it and "retained a form of gold exchange standard." The Act, as recommended by the Commission, imposed an obligation on the Government to buy gold whenever offered to them at a fixed rupee price; but whereas the Commission recommended a similar obligation to sell gold at a fixed price either in Bombay or in London *at the option of the purchaser, the Act gave the Government an option either to deliver gold in Bombay or sterling in London.* Further the psychological element

required to understand the change from an exchange standard to a bullion standard has been wanting. The value of goods and services is measured in terms of silver which is still our standard of value. The gold "rupee" is only a fiction.

Gold Standard and Reserve Bank of India Bill

The other bill brought by the Government was the Gold Standard and Reserve Bank of India Bill which was placed before the Legislative Assembly in January, 1921. It embodied all the main recommendations of the Commission with regard to the establishment of a gold bullion standard and the Reserve bank. It raised, however, a controversy as fierce as that raised by the ratio question. The Joint Select Committee, to which the Bill was referred, altered some of the main provisions of the Bill; decided that the Bank should be a State Bank, and not a Shareholders' Bank as proposed in the Bill; modified materially the composition of the Board of management; and made the members of the Legislative Assembly eligible to the membership of the Board of Management. When the amended Bill came back from the Select Committee, it was once more hotly debated; the debate centred round the question whether it should be a State Bank or a Shareholders' bank. The amendment of the Select Committee relating to the eligibility of the members of the Legislative Assembly to the membership of the Board of Management also called forth an equally long and heated debate.

When the debate was going on in full swing, the Government took the House by surprise by their proposal to convert the proposed Bank into a Stockholders' Bank. But before the new proposal was taken into hand, further proceeding had to be suspended by the order of the Secretary of State for India. Sir Basil Blackett, the Finance member, went

to England for consulting the authorities and on his return placed before the House a new Bill, framed on the lines of the original Bill with a few modifications. The President of the Legislative Assembly disallowed any discussion on the new Bill on the ground that the old Bill was still before the House and had not been formally withdrawn. The new Bill was consequently dropped. The Government since then have not made any attempt to frame a new Bill and place it before the House.

The importance and necessity of the Reserve Bank was recognised by all. That its absence was a serious drawback in our currency system and was responsible for the failure of the currency to work properly was admitted on all hands. The controversy that arose over it ranged round the side-issues only.

1927—1931.

We will now summarise the position of our currency system as it stood from 1927 to 1931.

1. The rupee remained, as it is to-day, the principal form of currency; it was also full legal tender.

2. Gold coins were no legal tender; though the Government undertook to receive gold coins in the Mints at 1s. 6d. per rupee.

3. Though rupees could be obtained in exchange for gold of not less than 40 tolas at Rs. 21-3-10 pies per tola, gold could not be obtained in the same way in exchange for rupees. The Government had the option of selling either gold in Bombay or sterling in London.

4. The price of the rupee was maintained between the upper and the lower points by the purchase and sale of sterling, respectively. The price of the rupee, therefore, varied between 1s. 6d. plus the cost of shipping gold, insurance and interest and 1s. 6d. minus cost of shipping, etc.

The most important change that was introduced during this period was the suspension of the sale of Council Bills and the inauguration of the system of purchase of sterling in India. Remittance was not made to England by the sale of Council Bills but by a new system which was inaugurated in April 1927. This was the system of purchase of sterling in India by public tender; this is also the present system. Tenders are received once a week, usually on Wednesday, simultaneously in Calcutta, Bombay Madras and Karachi, and particulars of the amount allotted at each rate, if any, are published in each of these places on the following days. Between the days on which tenders are received intermediaries are offered at the offices of the Imperial Bank of India in these places at a rate usually $\frac{1}{3}$ above the highest rate accepted on the previous day on which the tenders were received. The exchange varies from day to day and from month to month. It usually shows signs of strength during the busy season of the year when there is a heavy demand for money for moving the crops to the ports; it slackens during the rest of the period. The balance of trade was generally in favour of India; consequently there was little necessity for selling sterling in India on London. The amount of sterling purchased and the rates of the purchase in each year from 1927-1930 are given below :—

Purchase of Sterling.

Years.	Sterling.	Purcha- sed in India.	Average.
	£	Rs.	S. D.
1927-1928	28,325	37,77,30	1—5·997
1928-1929	30,810	41,02,18	1—6·02
1929-1930	15,215	20,39,12	1—5·907

Rupee-sterling Exchange, September 1931

England went off the Gold standard in September, 1931 and was followed in its wake by Norway, Sweden and Denmark. There had been, for sometime past, an unequal distribution of gold. Much gold accumulated in America and France, whereas some other countries were depleted of it. Some of the countries which adopted gold standard after the conclusion of the War have to abandon it for shortage of gold in the Central Banks as the proper working of such a standard depends on the amount of gold held by the Central Banks. This is the defect, very serious and disturbing in its effect, of a metallic standard. An unequal distribution upsets it; shortage of gold brings about fall in prices, contraction of business and credit and a world-wide disturbance.

But India had a greater evil for her. Immediately England went off the gold standard, the Secretary of State for India announced that the rupee should be linked to sterling. The Government of India accordingly by an executive fiat, an ordinance of 1931, linked the gold rupee to sterling. It will not serve any useful purpose by condemning the astounding step taken by the executive authorities. It has proved, if any proof is required, that India must still depend on the arbitrary order of her irresponsible executive, even

in matters relating to the currency policy of the Country. The much vaunted "gold rupee" and the "gold standard", though more fictitious than real, have been, by a stroke of pen blotted out from the statute book.

The wisdom or the folly of the step taken, it is yet too early to judge. But the implications of the step should be clearly understood. Sterling is an inconvertible paper currency. An inconvertible paper has every chance of depreciating in terms of gold; sterling has already depreciated. But if it does not depreciate, there is nothing seriously wrong with the position; but it is likely to depreciate. What is worse is that it may depreciate heavily, as heavily as the francs and the marks did in 1921-25. Further an inconvertible paper is liable to be inflated by political parties to serve their petty ends and strengthen their political power; if it is so inflated, there is no knowing where it will stand. And the rupee is to follow it in all its vicissitudes.

Advantages and disadvantages of linking the rupee to inconvertible sterling at 1s. 6d. It is hoped that certain advantages, named below, are likely to accrue from linking the rupee to inconvertible sterling. They are:—

1. The rupee will depreciate in value with sterling. A depreciating exchange, as noted in previous chapters, will stimulate exports to the gold standard countries. In fact it is a bounty on Indian exports.

2. As the rupee depreciates, prices will rise in India.

3. The difficulty in framing the budget, arising from unstable exchange, has been removed. With the fixed value of the rupee in terms of sterling, there will be no difficulty in discharging the sterling obli-

gations. Had the rupee been kept linked to gold, as of old, the sterling would have fluctuated in terms of rupee, and all the difficulties, experienced by the Government from 1872 to 1893 in framing the budget, would have arisen.

4. Indian market is secured for English products against the competition of gold standard countries. As the sterling depreciates in terms of gold, an article worth one pound sterling will cost to an Indian importer only Rs. 13-5-4 pies at 1s. 6d. sterling per rupee; but an American article for which formerly the Indian importer paid Rs. 13-5-6 pies will now cost more, may be Rs. 15 or more. The Indian importers will be tempted to prefer English goods to American goods.

5. The trade relation between England and India will remain stable.

6. The difficulty of the Government to maintain the rupee at 1s. 6d. gold will be removed to a great extent.

There are also the *disadvantages*. They are as follows:—

1. As the value of the rupee in terms of gold will fall, imports into India from countries with gold standard is likely to be discouraged. A falling exchange stimulates exports and hampers imports.

2. As exports pay for the imports, reduction in the volume of imports is likely to decrease the exports.

3. The Indian currency shall have to follow the British currency. There are likely to be fluctuations in prices and the consequent disturbances in the economic structure of society.

4. This uncertainty and the depreciation of the rupee and sterling in terms of gold or, which is the same

thing, appreciation of gold in terms of rupee and sterling are mainly responsible for the "flight" of gold from India.

APPENDIX A.

The Government Scheme for a Gold Currency.

1. Gold Coins and Bank notes should be unlimited legal tender and silver rupees should be legal tender up to Rs. 50 only.
2. A statutory obligation should be placed on the Government to give gold coins in exchange for gold bullion.
3. A statutory obligation should be placed on the Bank to buy gold.
4. Bank notes should be payable on demand in gold coins.
5. The constitution of the new reserve should be as follows:—
 - i. Gold holding should not be less than 30 per cent, subject to reduction on payment of a tax.
 - ii. Gold securities or sterling trade bills should not be less than 20 per cent.
 - iii. Remaining investments should be held in Government of India securities (not more than 90 crores) and internal trade bills.
6. The Bank should undertake to supply the Secretary of State with funds to meet the sterling charges.

The rupee could not be limited as legal tender, until an opportunity had been given for the holders of rupees to convert them into gold. It was assumed that about 110 crores of rupees might be presented for conversion. As it

was impracticable to provide for the conversion of such a large amount, the following stages were accordingly suggested:—

- i.* A statutory obligation on Government to sell gold bullion in bars of 400 ozs. at par and to buy gold at par less seignorage.
- ii.* As soon as sufficient gold was available, a gold coin was to be put into circulation and offered as freely as resources would permit, but without any definite obligations.
- iii.* After, say, five years the liability to give gold coin in exchange for notes and rupees and also for gold bullion on payment of seignorage should be imposed.
- iv.* After a further five years the silver rupee should be made legal tender upto a small fixed amount, say, Rs. 50. During the transition period it was assumed that the total of the gold and gold securities in the reserve might be allowed to fall as low as 30 per cent.

The Government would have at their disposal 200 crores of rupees (110 crores for conversion plus 90 crores in the reserve). It was proposed that this amount should be sold in ten years. The average price obtained might be expected to be not less than 24d. per oz. The amount of gold required on the basis of a note-issue of 189½ crores for introducing the scheme in all its stages would be:—Rs. 27·2 crores additional for the reserve plus Rs. 110 crores for the conversion of the rupees; total Rs. 137·2 crores, or £103 millions.

It was estimated that £15 millions of gold would be required in the beginning, £35 millions within a year and £53 millions over a period of ten years.

APPENDIX B.

Average Value of exports and imports of gold coins and bullion from 1900-1 to 1929-30.

	IMPORTS.			EXPORTS.			Net Imports or exports.
	Bullion.	Coins.	Total.	Bullion.	Coins.	Total.	Imports+ Exports—
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Average for 1900-01 to 1904-05	5,72,18,318	9,34,97,221	15,07,15,539	4,85,71,823	3,97,71,942	8,83,71,765	+6,23,43,774
„ „ 1905-06 to 1909-10	9,65,96,452	7,83,64,643	17,49,60,495	3,34,76,990	2,40,30,440	5,75,01,430	+11,74,53,065
„ „ 1910-11 to 1914-15	18,49,74,877	16,42,39,395	29,92,14,272	3,07,89,183	1,50,03,372	4,57,92,555	+25,34,21,717
„ „ 1915-16 to 1919-20	14,94,65,335	4,70,19,473	19,64,84,708	4,91,96,247	1,31,45,685	6,23,41,932	+13,41,42,776
„ „ 1920-21 to 1924-25	28,54,42,004	7,90,80,246	36,45,22,250	6,99,52,231	74,74,737	7,74,26,968	+28,90,95,282
1925-26	25,26,78,910	9,96,20,393	35,22,99,363	23,26,183	14,27,381	37,53,564	+34,85,45,799
1926-27	13,86,46,145	5,63,65,857	19,50,12,202	4,91,792	5,14,762	10,06,554	+19,40,05,448
1927-28	11,42,46,018	6,70,98,041	18,13,44,062	98,300	2,45,739	3,44,039	+18,10,00,023
1928-29	11,81,68,903	9,40,20,789	21,21,89,692	1,05,437	97,257	2,02,714	+21,19,978
1929-30	6,83,46,025	7,39,65,452	14,23,11,477	65,559	37,522	1,03,081	+14,22,08,396

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ERRATA

Page	87,	line	31	For '1913' <i>read</i> '1893'
Page	93,	line	18	For 'raised' <i>read</i> 'lowered'
Page	94,	line	22	For 'are' <i>read</i> 'were'
Page	104,	line	4	For 'is' <i>read</i> 'was'
Page	118,		last line	Add 'first' after 'released'
Page	144,	line	3	For 'afterwards' <i>read</i> 'now'