

OFFICE OF THE ECONOMIC ADVISER TO THE  
GOVT OF INDIA

# MEMORANDUM

ON

## INDIAN MONETARY POLICY IN THE POST-WAR PERIOD

BY

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PUBLISHED BY THE MANAGER OF PUBLICATIONS, DELHI  
PRINTED BY THE MANAGER, GOVERNMENT OF INDIA PRESS, CALCUTTA  
1945

Price annas 4 or 5d.

## INDIAN MONETARY POLICY IN THE POST-WAR PERIOD.

The following memorandum has been prepared by the Economic Adviser in his personal capacity, and is not to be regarded as expressing the views of the Government of India, or of any Department of Government.)

### A.—The Pre-war Patterns

1. It is a commonplace of monetary history that the international gold standard, towards the restoration of which all the energies of monetary reformers were bent in the first half decade following the first World War, broke down again within a decade. Into the causes of this breakdown it is not necessary to go at length: a currency collapse may occur either because those who are responsible for the management of the currency are unable or unwilling to work it according to the appropriate "rules of the game", even though the circumstances are otherwise propitious, or because the environment is such as to make it impossible to apply the necessary rules. An international gold standard involves at least the following minimum conditions for successful operation so far as "the rules of the game" are concerned: a determination to maintain fixed parities: a willingness to expand or contract the volume of purchasing power if gold is acquired or gold is lost: agreement to pursue these policies *simultaneously* in the areas, respectively acquiring or losing gold: a willingness in each area to submit to the consequences of credit expansion and contraction. The continued successful working of an international gold standard also implies that the exchange rates to which it is intended to adhere are initially reasonably adjusted to cost-and-price levels: that capital movements (whether short or long-term) are not of such intensity (as regards absolute volume or of urgency in time) as to exceed the transfer-capacity of the system: (in other words, that the commercial and fiscal arrangements of the world are such as to allow capital movements to be adjusted primarily by a movement of goods and only marginally by a movement of gold itself, and that such movements are not exaggerated by panic or distrust, arising from expectations, that the system would not survive the strains to which it might be exposed): that when corrective methods are applied, the economic environment is such as to produce the hoped for consequences; in other words, that the economic structure is sufficiently plastic to respond to changes in the rate of interest or in the volume of credit outstanding: that the threat of War does not disturb "settled expectations" and so cause violent anticipatory changes in the capital and money-markets: finally, that cyclical and structural fluctuations are kept within manageable limits.

2. These various conditions did not co-exist in a sufficient degree in the early days of the restored gold standard and they never co-existed in a sufficient degree subsequently. Those who restored the gold standard perhaps took it for granted that once that standard had been restored, it would modify the environment sufficiently to adapt it to the requirements of the standard, but events, in that case, grievously disappointed them. So far from the environment being modified by the international gold standard, the restored gold standard was modified by the environment. Thus there evolved, for instance, in the twenties the then much lauded twin policies of "offsetting" and "sterilisation" by which gold-exports were *prevented* from bringing about those deflationary consequences in the gold exporting country which would have prevented a further *loss* of gold and by means of which, also, gold imports were prevented from bringing about those inflationary consequences in the gold importing country which would have prevented a further *gain* of gold. The natural consequences were of course, that countries losing gold *continued* to lose gold and countries gaining gold *continued* to gain, without

equilibrium being restored and *these* gold losses accentuated the strain on the standard already involved in large capital movements, by leading to panic movements of short-term funds, due to fears that the system could not stand the strains imposed. Such fears because they involved gigantic movements of funds, justified themselves *ex post facto*; the system proved unable in fact to stand the strain, especially when this strain was superimposed, as there is reason to suppose that it *was* superimposed (*e.g.*, in the case of the United Kingdom) on an original set of exchange parities which distinctly over-valued the currency.

3. At this distance of time it is useless to go into the very controversial issue as to which, amongst the complex of factors at work, were the ones which contributed *most* to the breakdown of the standard: unsuitable parities, exaggerated movements in the volume of funds, mistakes of policy or the growing inelasticity of the economic structure. All these factors and others also contributed. The importance of a correct analysis of the past lies in the guidance it may give as regards the future, and the breakdown of the gold standard should act as a perpetual warning against overstressing the technical aspects of proposed currency schemes and understressing the connexion between the underlying principles of currency schemes and the nature of the economic environment in which such schemes must operate.

4. It is well, before passing away from a discussion of the gold standard to a discussion of the systems which have succeeded it, to consider in more detail certain aspects of the practical working of the international gold standard which find no place in formal discussions of the working of that standard, but which, nevertheless were of profound significance.

5. The *first* of these practical aspects concerns the place of London as for many decades the financial centre of the world. This effected the working of the gold standard in several ways. Firstly, since a considerable portion of the international trade of the world was financed by bills on London—the procedure is too well known to require detailed explanation—there was at all times a “float” of short-term balances in London which the London banks could utilise in adjusting a temporary debtor position in the international accounts of any single country. Brazil or the Argentine, for instance, finding their London balances depleted at a time when heavy-interest payments were due, could borrow in London, but the ability of London to lend was conditioned by the excess creditor position of other areas which were, for the time being, accumulating Sterling, in consequence, say, of heavy imports into the United Kingdom, representing the proceeds of their current harvests. Therefore, long before Lord Keynes thought of rationalising the world’s monetary institutions by the formal creation of a “Clearing Union”, the aggregation of London finance-houses had already adopted the principle of working implied in such a clearing union. The net effect was a considerable economy in gold shipments all-round the world.

Secondly, so long as Sterling was equal to a defined weight of gold, which was always obtainable in demand, the possession of a Sterling balance presented great conveniences to the holder. Such a balance was held in the place where it was most likely to be wanted if there were a deficit in the international account: it could be invested “short” and bring in a little interest: it could at need be turned into gold and owing to the ubiquity of payment in sterling—a Sterling balance was constantly being replenished, not only by sales to the United Kingdom but by sales elsewhere. Thus, in fact, the various “gold-exchange standards” which, formally or informally, constituted the monetary systems of a good many countries were, in reality, sterling-exchange standards. The most obvious advantage—on which the

text books were wont to dwell—was the economy of gold involved. What was at least of equal importance was the fact that in so far as credit expansion and contraction was required in order to maintain equilibrium, such contraction and expansion was affected directly through the influence exerted by British monetary policy upon the volume of Sterling balances held in London, and the mechanism by which this influence was exerted was a very direct one. So long as, and in so far as, Sterling represented the ultimate basis of credit for the overseas world, what is now called "the Sterling bloc" in fact already existed, though the world *thought* in terms of gold.

6. It is, of course, no accident that the gold standard worked best when, in addition to there being well-defined and generally accepted "rules of the game" and an economic and financial structure adapted to the general requirements of the system, the leadership was in the hands of a single institution, whose principles of action, being known, could be anticipated, and, being anticipated, would thus be strengthened by the self-discipline of the market, which knew that *unless* it followed the lead of the institution, it could be forced to act as the institution desired.

7. For a considerable period of time before the outbreak of the first World War, the role of monetary leadership was assumed by the Bank of England. In the post-war period, when conditions generally were far less favourable to the success of the standard, that single-minded leadership gave way to a loose triumvirate of the Governor of the Bank of England, the Governor of the Reserve Bank of New York and the President of the Reichsbank. The creation of the "Bankers Club", i.e., the Bank of International Settlements might have led, under happier political circumstances, to the creation of a real international centre of authority.\* But the Bank of International Settlements became caught up in the meshes of German power-policy and its usefulness as a forum of international discussion correspondingly declined. But the lessons of the past are there for the world to see: an international standard requires international agreement as to principles, if it is to be successful. There must be a single undivided centre of authority or there must be, if not chaos, at any rate, constant friction and difficulty.

8. The international gold standard did not break down in a day. The crisis began in Austria in 1930, extended to Germany, affected the United Kingdom and the countries of what subsequently became known as the "Sterling area" in 1931 and only later affected the U. S. A. and the countries of the so-called "gold bloc". The year of greatest storm and stress was 1931. Between May and November of that year, sixteen countries introduced exchange control.† In some respects the crisis continued until the outbreak of the War—thus it was not until the passage of the Currency and Bank Notes Act on February 1939 that the *formal* transition from a gold standard to a sterling-standard took place in the United Kingdom, for that Act repealed Section 4 of the Bank Charter Act, 1844, requiring the Issue Department of the Bank of England to issue notes in return for gold. But nevertheless, it is true to say that by that time a new pattern of international monetary institutions had evolved. In order to place the new monetary proposals in their proper context it is desirable to analyse what the more prominent features of the new situation were.

9. The first of these features was the emergence of fairly closely articulated currency "blocs". For reasons already explained, even the gold standard

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\* See, for instance, the activities referred to in the Third Annual Report of the Bank of International Settlements (Basle 1933), pages 22--25.

† League of Nations Monetary Review, 1937-38, Vol. I, page 30, *vide* also Tables I and II, pages 107 and 108 of the same publication.

only veiled the existence of a Sterling area: in the period which followed the Breakdown of Gold the differentiation between the " blocs " became more marked: groups of countries associated themselves either with the Dollar, or with Sterling or with the Reichsmark or, for a time and abortively, with gold. The essential feature of such a bloc was the maintenance of relatively stable rates of exchange within the bloc.

10. The second feature of the post Depression period was the prevalence of exchange-controls.\* " Exchange control " is a vague term covering a very wide variety of devices: the severity with which it was applied differed greatly from one country to another, and in some cases there was even a tendency towards relaxation. In certain cases, at least, exchange-control culminated in a complete centralisation of all foreign exchange transactions by offset through a " clearing department " of the Central Bank or through a separate clearing institution. As a bye-product of exchange-control and clearing there arose surely the most remarkable phenomenon which has characterized monetary history—the multiple-valued currency, so that it became possible, for the same unit of account, the Reichsmark for instance, to possess different values for different purposes.

11. The third feature of the post Depression period was the creation in a certain number of countries, of Exchange Equalisation Funds.† These funds differed in constitution *inter se* and some of them were *not* technically well fitted to attain their objective, which was not so much the stabilisation of the exchanges, as the neutralisation of the influence of the inflow and outflow of funds. When, for instance, foreign funds were freely offered to the London Money Market, the British Equalisation Fund sold Treasury Bills and bought exchange (including gold) and thus prevented an expansion of the total funds at the command of the Money Market: when foreign funds were withdrawn, the Equalisation Fund sold exchange and received Sterling and by reinvesting the Sterling, so received in Treasury Bills, restored to the market the funds it might otherwise have lost. The exchange Fund, in fact, was an up-to-date device for continuing the processes of " sterilization " and " off-setting " which had previously been carried on by the Bank of England. But though these Funds did not exert a direct influence of the *de facto* stabilisations which were also a feature of the post Depression period, they did exercise an indirect influence, in that their existence provided a mechanism both for insulating the domestic market *and* for avoiding the necessity for allowing exchange variations. An influx of foreign funds, under free standards, acts directly to raise the value of the local currency, and an efflux lowers it—and exchange fund which *impounds* foreign funds, acts just as did the gold reserve of the Central Bank under the gold standard, as a means of keeping the rate steady, *within the limits of the resources possessed by the Fund itself.*

12. These facts about pre-war Equalisation Funds must be appreciated if the U. S. A. proposal for an immense Stabilisation Fund is to be understood. The U. S. A. proposals in fact do not relate very closely *in intention* to the Equalisation Funds of the immediate pre-war period. The Stabilisation Fund proposals link up much more closely, so far as intention is concerned, with the orthodox idea of a reserve to be used for emergency purposes than with the idea of a fund for directly offsetting the impact of external forces on the internal economy.

13. Reference has already been made to the greater stability in the rates of exchange which followed on a preliminary period of confusion. The turning

\* For a sketch of development, *vide* League of Nations Monetary Review, 1937-38, Vol. I, pages 30 to 36.

† *Vide* Monetary Review, 1936/37, Vol. I, pages 52 to 59.

point came, for a number of important currencies in 1935 (including Sterling): the revaluation of the U. S. A. Dollar had been provided for in the Gold Reserve Act in the previous year. But this period of renewed stability presented some features quite unlike those of the Gold Standard era which it replaced; the stabilisation was provisional both in the sense that fluctuations could and did occur *and* in the sense that there was no *legal compulsion* to adhere to any specific rate of exchange—indeed, as already pointed out, the legal abolition of the gold standard in Great Britain was only completed shortly before the outbreak of the second World War. And in all cases stability, when it came, involved a drastic change of the value of the local currency in terms of gold.

14. Since one of the most important questions of the future will be the place to be assigned to gold in the monetary systems of the world, it is necessary to go somewhat fully into the place which gold occupied in the world's monetary systems just before the War. The story of gold in the period, 1931—39, is, scientifically regarded, possibly the most paradoxical aspect of that paradoxical age. The worship of the golden calf had been denounced by the then Maynard Keynes (now Lord Keynes) long before the breakdown as a "barbarous relic" (in his "*Tract on Monetary Reform*"). For reasons to be analysed more fully in a subsequent section, the tide of political, nationalist and intellectual opinion was running high against gold. At last it seemed as if the events of 1931 were finally to dethrone the Monarch whose Dynasty stretched back into such vast and impenetrable depths of the past that no effort of the scientific imagination could even venture to assign a beginning. Facts proved otherwise.\* Between 1929 and 1939 the world's output of gold in physical terms, expanded greatly and this movement continued even into the first full year of the War. "Even if, in the absence of official indications, the estimate for the gold output of the U. S. S. R. be reduced from 4.5 million ounces in 1939 to 4 million ounces in 1940, the gold production of the world attained a new record of 40.7 million ounces in 1940—4½ per cent. above the previous year. For the first time the figure of 40 million ounces has been exceeded, compared with less than 20 million ounces produced in 1929. Taking into account depreciation of currencies since 1931, the rise in value is, of course, steeper than the increase in physical output: in U. S. Dollars of current value the production has increased by more than three times since 1929".† It is true that India and other Eastern Countries, indeed Overseas producing countries generally, lost gold, but this was not due to any decline in the general acceptability of gold, but to economic distress and dishoarding in the East. It was accompanied by an immense new hoarding demand in the West (though there was a "gold scare" in 1936 this again was simply due to the fear that the U.S.A. Treasury's gold buying price might be lowered). Even those countries, such as the United Kingdom, which had "abandoned" the gold standard, largely added to the Reserves of Central Banks and Exchange Equalisation Funds—though, of course, the monetary value of their gold stocks was swollen by the fact that gold was being valued at higher rates in terms of money. Taking the world as a whole, there was no sign whatever that gold was losing its significance either as a "store of value" or as the most generally acceptable available means of *liquidating outstanding international indebtedness*.

\* *Vide* League of Nations, *Monetary Review*, 1936/37, Vol. I, pages 59 to 77 and the Annual Reports of the Bank of International Settlements, *passim*. These Reports must be regarded as the most valuable single source of information now available in regard to the remarkable events to which reference is made above.

† Eleventh Annual Report of the Bank of International Settlements, page 89.

15. What derogation of sovereignty then had gold sustained in the period 1931-39? Broadly speaking, gold had ceased to be, to the extent that was the case under the gold standard, the ultimate determinant of the volume of purchasing power. Even under the gold standard, there is not necessarily any automatic expansion of the volume of purchasing power as the volume of gold expands, for it is possible to "sterilize" gold, nor any automatic decline in the volume when gold volume declines, since it is possible to "offset" gold losses deliberately. And even under the post depression arrangements, gold purchases by the Central Bank or Exchange Fund would have meant expansion, and gold losses contraction, unless sterilized or offset respectively. Thus the mechanics of the position had not changed as directly as might be thought at first glance. But whereas under the gold standard, it was necessary to maintain, in the ultimate analysis, a volume of purchasing power not inconsistent with the maintenance of a fixed relation between gold and the national unit of account: under the post Depression arrangements it became possible to aim at the maintenance of a defined volume of purchasing power and to adjust the gold stock to that volume, as a bye-product, as it were of credit-policy. And the credit-policy itself was "cheap money". The desire to maintain a policy of "cheap money", it must be specifically pointed out, was not the cause of the monetary breakdown of 1931 and indeed it would have been possible had there been any kind of true international agreement to have implemented a general cheap money policy even with the old parties and with the old gold standard.\* But the breakdown having taken place as a result of successive losses of confidence in currencies, a cheap money régime was inaugurated and became, *ex post facto* as it were, the main determinant of monetary policy and monetary institutions.

16. It seems desirable to draw attention to three other matters. The first is that pre-occupation with the reconstruction of some kind of world monetary order began almost with the onset of the crisis in 1929 and though the cause of monetary internationalism received a rude set-back as a consequence of the failure of the World Economic Conference of 1933—owing mainly to the opposition of the U. S. A.—to arrive at agreement, yet it was possible, within a relatively short period after the debacle to sign the Tripartite Monetary Agreement of September 26, 1936 (which was followed by a subsidiary technical agreement relating to reciprocal gold-earmarking facilities on October 12). This agreement between the United Kingdom, France and the U. S. A. is important in that whilst recognising the necessity for taking into "full account the requirements of internal prosperity of the countries of the Empire,† as corresponding considerations will be taken into account by the Governments of France and of the United States of America" it also recognised the principles (i) that when currency devaluations became necessary, they should be subject to international agreement (France was in fact desirous of devaluing her currency), (ii) that international co-operation was desirable and in fact that three Governments trusted "that no country will attempt to obtain an unreasonable competitive exchange advantage and thereby hamper the effort to restore more stable economic relations which it is the aim of the three Governments to promote".

17. Secondly, the Tripartite Agreement clearly derives from the two divergent streams of thought which have been in conflict throughout the

\* But this is not tantamount to arguing that even an international monetary agreement could have prevented the events of 1930-31, though the present writer is of opinion that such an agreement probably would have done so.

† Analogous statements as to the necessity for paying regard to the internal requirements of prosperity were made in the American and French texts, which differ somewhat *inter se* vide Annex VII of the Seventh Report of the Bank of International Settlements.

greater part of the inter-war period: the conflict (which is in reality part of a much wider conflict of ideas) between those who believed that "internal prosperity" could be attained by an autonomous monetary policy and those who believed that (in the long run, at any rate) "internal prosperity" could not be bought at the expense of international monetary disorder and that, within whatever limits monetary autonomy might function, some limit must needs be set. This conflict has, by no manner of means, been solved: it remains the *crux* of the problem of practical monetary policy.

18. The final matter which requires mention at this stage of the argument is the relationship between monetary policy and commercial policy. It must be pointed out that the attempt to maintain the *de facto* rate of exchange at a time of monetary panic and/or a high and unsuitable price/income structure through high duties or exchange-controls, contributed—in some cases powerfully—to exchange-control and other devices highly deterrent to international trade. But the seed fell upon well-prepared soil: there was a general disposition to erect higher trade-barriers in the interests partly of local employment possibilities and of self-defence. (It may be noted that the United Kingdom adopted protection *after* the abandonment of the gold standard when the defence that protection was required to safeguard the over-valued position of the pound sterling had lost all its validity.)

#### B.—*The Post-war Monetary Position.*

19. Before discussing either the Keynes or White Plans, or entering into any examination of India's position, it is necessary to consider, in general terms, the monetary position at the end of the War. That that position will be one of great complexity and delicacy admits of no doubt whatsoever. There are at least the following issues which must be faced at once at the end of the War:—

(i) The first of these is that presented by the "banking-up" of purchasing power, particularly in the Western democracies, but also present elsewhere. By savings devices, crediting to post-war accounts a portion of the taxation now being extracted from the tax payer, by the piling up of bank-balances and of note-holdings for which no immediate outlet in objects of expenditure can be found, an immense potential demand for goods exists. The entire world has been and is being starved of commodities and the future price-level must depend largely upon the degree of release of these funds, on the one hand, and the readaptation of productive power on the other. An uncontrolled orgy of spending will result in a great uprush of prices: on the other hand, the demobilisation of the vast army of munition and other war workers and of the armed forces themselves will be facilitated by the exercise of effective demand on the part of the owners of purchasing power. The future of the price-level over large parts of the globe is thus still entirely indeterminate, since it is not yet apparent to what extent populations starved of goods will submit to further privations at the end of hostilities, and tolerate the indefinite continuance of war-time controls.

(ii) A second element of uncertainty is the necessary scale of *public expenditure* after the War. The cessation of war expenditure would, of course, exercise, in and of itself, an enormous deflationary influence except to the extent that it is offset by private spending—both on consumers' and capital goods—on the lines indicated in (i) above. But it is certain that any appearance of large-scale unemployment would be the signal for further governmental expenditure. The deflationary effects of a cessation of war expenditure are therefore liable to be offset by an alternative and ancillary form of public expenditure.



(iii) In the absence of any internationally co-ordinated programme of domestic policy—and it must be recognised at once that this is enormously difficult to achieve—the effect of these forces will obviously affect different countries in different degrees. It follows that the establishment of equilibrium rates of exchange will be very difficult in the immediate post-war period. Economies, of course, interpenetrate, the price-level, *e.g.*, in the U. S. A., will affect through imports the level of prices in the whole of Europe. But this consideration does not dispose of the problem, since, obviously, *e.g.*, a low rate of exchange chosen on general grounds will also increase the internal level of prices or prevent it from falling.

(iv) The fourth element of uncertainty concerns the monetary position of those countries whose economies have been caught up in the German "New Order". Undoubtedly, at the end of hostilities some of these countries will find themselves in possession of considerable "frozen" balances in New York: some of them also will have accumulated gold and/or Sterling and/or Dollars as a result of possessing valuable war assets—*e.g.*, Dutch and Norwegian shipping and Dutch oil resources in the West Indies. Nevertheless, they also possess nominally large amounts to their credit in their clearing arrangements with Germany, and their effective demand over goods entering into international trade will in part, at least, depend upon the extent to which these clearing balances are worthless or not. If they are to be made capable of transfer into internationally valid currencies, the pressure upon available international resources will be increased.

Naturally, also, a rate of exchange will have to be established between the Reichsmark and the outside world. The effective purchasing power of the Reichsmark will be extraordinarily difficult to establish, because the nature of the post-war price and income structure of Germany is quite unknown, until the extent of the reparations and other claims upon her have been established.

(v) The creditor clearing balances which the European countries subject to the "New Order" have been accumulating are only a special case of what the White Scheme refers to as "abnormal war balances"—that is, accumulations of purchasing power received as a result of expenditure in one country for war purchases financed in the last resort by another. The leading case within the Empire is India. Any kind of post-war monetary policy will have to face the problem of the orderly liquidation of these balances, since the greatest lesson of the period tending to the breakdown of the Gold Standard is the impossibility of transferring large amounts without causing a breakdown of the mechanism of exchange.

### C.—The Keynes and White Plans.

20. Neither the British or American plans nor the Canadian "Compromise" plan are concerned in set terms with the *immediate* problems arising out of the war-situation, but yet these problems are ineluctable and if they are not to result in appalling muddle and suffering, there must be agreement on the main principles to be followed. These plans are concerned with long-term developments, and it would appear as if the only relevancy that they have to the immediate post-war situation is in providing a centre for discussion and secondly, in providing some of the short-term finance\* which may be required, *e.g.*, for the relief of countries like Poland. Even this later point is doubtful, since the creation of a separate Relief Organisation would suggest a direct approach to such problems.

\* This is specifically suggested in paragraph 39 (1) of the Keynes Plan, subject, however, to the qualificationary discussion in paragraph 42.

21. As paragraph 2 of the "General Observations" prefixed to the Canadian proposals rightly puts it, "The main objectives of the American and the British proposals appear to be identical, namely, the establishment of an international monetary mechanism which will aid in the restoration and development of healthy international trade after the War, which will achieve a high degree of exchange stability, and which will not conflict with the desire of countries to carry out such policies as they may think appropriate to achieve, so far as possible, economic stability at a high level of employment and incomes." If this is the fundamental objective how do the two plans propose to achieve it?

(i) The Keynes Plan proceeds upon the principle that within a closed system of accounts the amounts owing and owed must always be the same. It follows inevitably from this that if a country is buying at a rate in excess of its current sales, the rate at which it is running into debt must be exactly the same as the rate at which the rest of the world is running into credit. If the position is reversed, i.e., if the rest of the world now begins to buy from the country in question at a rate in excess of purchases by that country from the rest of world, there will be a reduction of the world's creditor balance and consequently an *equal* reduction in the debt balance of the country in question. The ideal situation is one in which every country's sales are running at the same rate as every country's purchases, because then there will be no debits or credits outstanding *at all*. But it is desirable also to maximise the flow of international trade. The emergence of a debt balance (and therefore also the emergence of a credit balance) may mean a check to trade, because the debtor country may stop buying: that tends to reduce the rate at which credit balances accumulate but it also means a check to trade. The position can be restored if the creditor country or countries accelerate *their* purchases, i.e., decelerate their credit-balances, but this may take time. In the *interim* period, to maximise the possibility of trade continuing at a high level, the debtor country must be helped to go on buying, which is the same thing as helping the creditor countries to go on selling. The *amount* of help to be given, under the Keynes Plan, is called a country's quota, and the unit of reckoning in which amount of help is to be estimated is called the *bancor*. If all countries agree to join the Union on principle, the total of *bancor* outstanding will (severally) exactly equal (1) the total of creditor balances, (2) the total of debit balances and (3) the total quota actually employed—since, in general *bancor* can only be created against unliquidated balances [subject however in the detailed plan, to a country's right to obtain against gold (Keynes Plan, Part II, paragraph 9)].

(ii) It is *not* intended that the volume of *bancor* should expand indefinitely. It is clear that creditor balances might expand greatly (and therefore debtor balances also) if instead of utilising creditor balances, creditor countries hoarded *bancor* and then the burden of financing countries with an adverse balance were thrown upon additional creation of *bancor*: or, to put it in another way, if debtor countries instead of inducing creditor countries to buy more from them by say, a reduction in their price-level, simply borrowed additional *bancor*. This might result in a very undesirable all-round rise of prices. The scheme, therefore, imposes limitations both upon a debtor country's right to borrow additional *bancor* (II, 8) and upon the *bancor* credit-balances of a Member State (II, 9).

Apart from these provisions it is suggested that both creditor and debtor balances shall be subject to charge (II, 7), so that "only a country which keeps as nearly as possible in a state of international balance on the average of the year will escape this contribution". But inter-State arrangements are

contemplated, so that "any Member State in debit may—borrow *bancor* from the balances of any Member State in credit on such terms as may be mutually agreed by which means each would avoid these contributions" (II, 7). Moreover, the charge on debit balances may be increased, and those upon credit balances remitted if "unduly expansionist conditions are impending in the world economy". Thus, by a back-door, the function of a Bank-rate is, to some extent at least, reintroduced.

22. The essential feature of the Keynes Plan is the creation of an international currency, the volume of which is a direct function of the degree of unbalance in the international "balance of accounts". The essential feature of the U. S. A. or White Plan\* is the principal of a ratio between a country's credit-worthiness and its borrowing capacity, or, taking the totality of all countries, between aggregate resources placed at the disposal of the system and the volume of aid that the system as a whole can furnish to individual components of the system. The contribution to be made to the fund is called a country's quota and the aggregate of such quotas (whether made in gold, its own currency or securities) constitute the resources of the Fund. The resources are to be valued in terms of a new unit of account—the *Unitas*. The Fund will thus work by placing at the disposal of Members, if they suffer a deficit in their international account, the particular foreign currencies which they require for the time being. A sale of say, Dollars, against Sterling diminishes the Dollar holdings of the Fund, and increases the Sterling assets of the Fund. It is clear that there must be a limit to the extent to which the Fund must be obliged to hold say, Sterling, in excess of the quota and the extent to which say, Dollars can be allowed to fall below the quota and rules have been laid down by which excess is to be regulated.

23. How to these schemes differ from the old international gold standard? Under the old international gold standard a country running into debt on its current balance could, so far as monetary resources are concerned draw on its own reserves of gold and/or foreign exchange, or borrow gold or foreign exchange from other countries. Sooner or later, unless it corrected its balance, it would find that its own reserves were exhausted and its borrowing capacity gone for the time being. Under that standard, therefore, it had either to take corrective measures or see its currency crash. Under the Keynes Scheme, a country can draw on such reserves as it possesses or borrow from other countries, but it can also utilise its quota† up to the limits allowed by the plan. If it goes on using up quota, it must submit to a graduated series of checks and controls (Keynes Plan II, paragraph 8). Under the international gold standard, creditor countries could go on accumulating gold and/or the currencies of debtor countries until the increase of their reserves compelled them to reverse their position or the assets of the debtor countries were exhausted. Under the Keynes Plan, the creditor country can go on accumulating *bancor* until the clearing union intervenes (see the discussion in Keynes Plan, III 7). But these arrangements work within an *elastic framework of expanding quotas in periods of expanding trade*—since "the quotas should be revised annually in accordance with the running average of each country's actual volume of trade in the three preceding years, rising to a five-year—average when figures for five post-war years are available."‡ It

\* This plan has undergone revision at several points and the following analysis is, therefore, couched in general terms.

† But it cannot go on using up its quota without surrendering a suitable proportion of its liquid assets [Keynes Plan 8 (6) (iii)].

‡ It is, however, very important to notice that under the Keynes Plan (II, 13) "The Governing Body shall be entitled to reduce the quotas of members, all in the same specified proportion, if it seems necessary to correct in this manner an excess of world purchasing power."

any internal readjustment of the cost/income structure by an appropriate variation of its rate of exchange. But what one country can do, it is open to others, to do also, and this obvious possibility completely alters the position: a *competitive* readjustment obviously does *not* fulfil the assumption of generally stable rates to which a *single* rate is readjusted. But single rate-changes are liable to provoke other changes also, for the reason that *all* countries are liable to feel that the degree of adjustment (in the case of a single country) has been excessive and that, therefore, the readjusted currency is now *under*, instead of being, *over*-valued. And yet a general readjustment will leave all countries in the same *relative* position that they occupied before the change took place.\* It is not easy to suggest any remedy which will obviously be generally satisfactory, but at this point it is desirable to inquire what the United Kingdom and U. S. A. plans respectively suggest.

Under the Keynes Plan, variations in exchange-rates are linked with the ratio between a country's debit or credit balance and its quota. The Plan provides in the case of a debtor country (i) for an autonomous power to lower the exchange value of the currency by not more than 5 per cent. as a single and no repetitive act, further changes to be dependent on assent, and (ii) for a *required* reduction in the external value of the currency, if the debit balance continues to grow and if the Board of the Union "deems that to be the suitable remedy" [Keynes Plan II, 8 (a) and (b)]. A country whose creditor balance is growing at an undue rate may be required to appreciate its currency in terms of *bancor* (Keynes Plan II, 9).

Under the American Plan, the provisions are much more detailed, and do not lend themselves to easy summation. The Plan provides (i) for initial rates which in general are those of 1st July 1943, subject to agreed alteration if this rate is "clearly inappropriate", (ii) for special conditions for liberated territories, (iii) for exceptional treatment during the first three years including the right to vary exchange rates by not more than 10 per cent., (iv) that the range of fluctuation of member currencies shall be determined by the Fund, (v) generally, that external charges shall be subject to consent by a fixed majority vote.

Subject to the exigencies of the immediate post-war period, the intention clearly is to avoid resort to exchange devaluation to the greatest possible extent: the *tone* of the Plan differs markedly in this respect from that of the Keynes Plan.

(iv) "*Abnormal*" *War Balances*.—On this subject, the Keynes Plan offers no detailed suggestions. The importance of the problem is recognised and the hint is thrown out that "perhaps there should be some special overriding provision for dealing with the provisional period only by which, through the aid of the Clearing Union, such balances would remain liquid and convertible into *bancor* by the creditor country whilst there would be no corresponding strain on the *bancor* resources of the debtor country, or at any rate, the resulting strain would be spread over a period".

The original American Plan provided for an elaborate funding scheme, by which (i) the creditor country obtained an immediate agreed advance, and (ii) the debtor and the creditor country bought back the advance over a term of years. The later version of the Plan has considerably modified this, since it appears that the proposal now holding the field is that the Fund may buy

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\* It may, of course, be argued that a general readjustment may permit, *e.g.*, of all-round internal "Reflation" and this is, in fact, the *ex post facto* justification put forward by some authorities for the period 1930 onwards. But, logically, an alteration of parities need not accompany an all-round rise in the price-level if that is properly *chronicised*.

blocked balances held in other member countries to an extent, in the aggregate, not in excess of 10 per cent. of the total quotas. A great deal will thus turn on the ultimate size of the aggregate quotas, and the amount of "abnormal war balances" and therefore borrowing powers outstanding at end of the War.

v) *Quotas and Borrowing Powers.*—As already pointed out, the Keynes links both quotas and, therefore, borrowing powers to the volume of trade: each country's quota is to be a function of the sum of its imports and exports aggregated together. There is a *prima facie* justification for this procedure, in as much as the whole Plan is intended to underpin the volume of international trade, but some countries, *e.g.*, Russia have a volume of foreign trade not in direct relation to their significance in the total world economy. In such cases, the Keynes Plan proposes a "special assessment". Moreover "It is . . . a matter for discussions whether the formula for fixing quotas should also take account of other factors". (Keynes Plan II, paragraph 5.)

The revised American Plan lays it down that a country's quota "shall be computed by an agreed upon formula which gives due weight to the important relevant factors, *e.g.*, a country's holdings of gold and free foreign exchange, the magnitude and the fluctuations of its balance of international payments, its national income, etc."

It is quite clear that taking the world as a whole, the land-locked countries would suffer, in general, from a formula which placed sole emphasis on foreign trade, *if the assumption is that rights to *bancor* or *unitas* are intended to underpin the entire economic structure.* But that is an assumption which is not necessarily justifiable. There is a danger that a large quota, or at least a larger quota than any uniformly applied formula will give, will be asked for, not as a matter of necessity, but as a matter of national prestige. In fact both the British and U. S. A. proposals recognise the necessity for a certain measure of elasticity. Before definitive proposals emerge from the various discussions now in process, the matter may be left at that.

(vi) *Voting Rights in the Plans.*—A system of Government in which voting rights vary, though it may be non-proportionately, with the size of a country's foreign trade, would of course favour countries such as the United Kingdom, New Zealand and Holland, whose *per capita* foreign trade is very considerable. A system of Government in which the basis of voting rights is the contribution made to the deposits of the system would favour the richer countries at the expense of the poorer: and, in so far as the contribution is made in gold, would favour countries with large gold reserves, as compared with those with small gold reserves. Public opinion in the U. S. A. and Great Britain has already seized on the disadvantages, from their own point of view, implicit in the proposals of the other and it is clear that a final compromise has yet to be found.

It is clearly undesirable that a single country should have such a sufficiency of votes as to be able to outvote all the others: it is equally undesirable that—as happened under the *Liberum Veto* of the League of Nations—necessary changes should be held up by a single small country. Within those limits a variety of compromises is possible. In international discussions, however, voting rights are not everything—the personality of a country's representative may give it an importance not to be measured in quantitative terms.

#### E.—India in the Post-war World.

27. At the end of the War, India will be faced with various outstanding problems, though these, so far as their essential characteristics are concerned, will be the common problems of the entire world.

is this element which most marks off *bancor* from gold, and a *bancor* standard from a gold standard.

24. Under the U. S. A. plan, there is no such automatically expanding (or contracting) framework and the resemblances to the rigidities of the international gold standard are much closer. After a preliminary readjustment at the end of three years, the quotas are to be revised at five-year intervals. (White Plan, II 5) though "in the period between adjustment of quotas, the Fund may increase the quota of a country, where it is clearly inequitable, out of the special allotment reserved for the equitable adjustment of quotas". So far as the position of debtor countries is concerned, the position under the American Plan is in principle not essentially unlike the position under the Keynes Plan: and indeed, the same can be said generally of the position of creditors. But since the Stabilisation Fund is an *endowed* fund, it will be seriously embarrassed if it runs short of a particular currency and the U. S. A. Plan foreshadows a resort to apportionment of sales, *i.e.*, rationing, in which case "it shall be guided by the principle of satisfying the most urgent needs from the point of view of the general international economic situation" (U. S. A. Plan V, paragraph 5). But this is, in fact, tantamount to exchange-control and, therefore, to a virtual breakdown, of the system.

25. It is apparent that everything will in practice turn upon the *manner* in which these fundamental concepts are implemented. The Keynes Plan is more explicitly expansionist in character than the U. S. A. Plan, but the object of both Plans is in fact to avoid those checks to the free flow of trade which resulted from current deficits in the balance of payments. But both Plans recognise that disequilibria cannot go on for ever, and rely upon administrative checks rather than upon the "quasi-automatic" checks implicit in the working of the gold standard. Much must depend upon the skill, judgment and courage of those called upon to work these Plans, and upon the willingness of both creditor and debtor nations to follow the advice which will be tendered to them. The most obvious danger will be, in an "expansionist" atmosphere, of undue delay, especially as the risk of dissatisfied nations leaving the scheme must not be under-rated.

#### D.—*Certain technical Aspects of the Keynes and White Plans.*

26. It will be desirable to survey in outline the manner in which the Plans propose to deal with certain outstanding problems.

(i) *Gold*.—The U. S. A. possesses the greatest single gold stock in the world holding at the end of 1941 nearly \$23,000 million out of a world stock of \$30,000 million,\* whilst the British Empire (especially Canada, South Africa, Australia and British West Africa) is the largest single producer of gold in the world.† A final demonetisation of gold would not necessarily destroy the market for gold; it might still be bought and sold in large quantities on private account, but it might seriously affect its value in terms of currency and therefore cause revolutionary changes, *e.g.*, in the economy of South Africa.

In fact, however, the Plans are far from demonetising gold and the American Plan is, in fact, exceedingly tender of the metal. Under the Keynes Plan, (i) the only limitation on gold dealings by member States is the requirement that they must not buy gold in terms of their local currencies "at a price in terms of their national currencies in excess of the parity

\* Twelfth Annual Report of the Bank of International Settlements, page 96.

† In 1941, out of the total world production of 41 million ounces, the four countries named in the text produced 54 per cent. Twelfth Annual Report of the Bank of International Settlements, page 87.

which corresponds to the value of their currency in terms of bancor and to the value of bancor in terms of gold"; (ii) as far as bancor is concerned, gold may be sold to the Union for bancor, though gold cannot be demanded against an offer of bancor to the Union. Bancor is thus to have a defined gold value, but this value may be changed from time to time.

Under the American Plan, (i) gold constitutes part of the deposit which Members must make (the amount of gold has actually been raised in the later versions, but as finality has not been reached, it is not worth while going into detail); (ii) the *Unitas* has a fixed gold value; (iii) member countries may not buy or sell gold above or below a figure which corresponds to the parities established between gold and unitas and unitas and the local currency involved; (iv) the Fund may buy and sell gold for local currency and hold gold; (v) may acquire excess gold holdings from Members above certain limits; (vi) the charges by the Fund for various services are payable in gold.

It is almost not too much to say that, whereas under the Keynes Plan, gold is ancillary to bancor, under the U. S. A. Plan unitas is ancillary to gold.

(ii) *Controls over Capital Movements.*—The Keynes Plan definitely presages a continuance of exchange-control (VII, paragraph 32) though "The advocacy of a control of capital movements must not be taken to mean that the era of international investment should be brought to an end. On the contrary, the system contemplated should greatly facilitate the restoration of international loans and credits for legitimate purposes" (VII, paragraph 35). But since "the universal establishment of a control of capital movements cannot be regarded as essential to the operation of the Clearing Union..... the method and degree of such control should be left to the decision of each member State" (VII, paragraph 33).

The U. S. A. Plan lists amongst its objectives the reduction of the use "of such foreign exchange restrictions, bilateral clearing arrangements, multiple currency devices, and discriminatory foreign exchange practices as hamper world trade and the international flow of productive capital" Nevertheless, as already pointed out, the scheme itself provides for the rationing of scarce currencies: and moreover "in order to promote the most effective use of the available and accumulating supply of foreign exchange resources of member countries", member countries agree "to discourage the excessive accumulation of foreign exchange resources and gold by its nationals. The Fund shall inform any member country when, in its opinion, any further growth of privately held foreign exchange resources and gold appears unwarranted".

But this is tantamount to admitting the principle of control over capital movements, so that, in effect, the United Kingdom and U. S. A. proposals are not so markedly different as would at first sight appear.

The obvious way out of this difficulty is the creation of a world in which panic movements of capital become a negligible risk. This involves political as well as purely financial and economic considerations. But unless confidence can be restored monetary arrangements in general will be dominated by fear, and control over capital movements will be only one amongst many evils which will follow.

(iii) *The plasticity of Exchange Rates.*—It is obvious that, for some time after the ending of hostilities, the appropriate rate of exchange between different currencies will be a matter of doubt. But this short-run difficulty important as it is likely to prove in practice, is not the main problem with which any long-term scheme is principally concerned. Given a generally stable system of exchange-rates, it is clear that a single country can evade

The first of these problems is the maintenance of employment and the monetary policy appropriate thereto. Though the retransfer problem from war to peace occupations will not be so formidable, in relation to the total population, as the retransfer problem in other countries, it will be considerable. The cessation of military expenditure (including exports for war purposes) will involve a downward movement of prices, except to the extent that new overseas and internal demands will spring up. It is probably safe to reckon upon a considerable degree of overseas demand and upon large replacement demands for some time, perhaps some years, after the war. Though the present price level cannot be regarded as definitive, the task of reconstruction would be greatly embarrassed if deflationary forces forced prices down too far towards the pre-war level; among other things, it would gravely increase the burden of the national debt. Without going further into the issues involved, the external aspect of this internal problem centres round the *rate of exchange*: for if the exchange-rate overvalues the rupee at the then current level of prices in relation to prices ruling elsewhere, either the rate of exchange must be varied or monetary reserves be drawn upon to protect the rate.

The second problem relates to the *direction* which India's post-war trade will take. If, to take an extreme case, India's foreign trade were to be entirely, in the post-war period, with the U. S. A., the exchange banks will constantly find themselves buying dollars and there will be at all times a "float" of that currency. If Indian trade is largely with the Sterling area or with countries whose currencies are linked with the Sterling area, the commercial and exchange banks will carry a "float" of sterling and/or associated currencies.

Whilst it is not at all impossible to imagine a country whose trade relations are primarily with one currency area keeping its reserves in terms of another currency, this is, obviously only possible without difficulty if the two external currencies are easily convertible into one another. Any extension of modern bilateral arrangements by which, e.g., the proceeds of sales to a given monetary area are "blocked" in the books of the Central Bank or the Central Clearing Office and can only be used for purchases in terms of the currency of the monetary area in question, or can only be transferred into a third currency of the pre-determined conditions, would prevent India (or any other country for that matter) from linking the external value of its currency to another and yet at the same time conducting the major part of its foreign trade in terms of a third currency.

From this point of view, the problem which is raised is the external standard (if any) to which the rupee is to be linked and the expediency, under the various conditions of the external world, of associating or dissociating the external standard from the currency of the major trading areas with which the trade of India is likely to be conducted.

Lastly, there is the question of the effective utilisation of the Sterling balances accumulated during the War. There is general agreement in India that these Sterling balances should be utilised to strengthen India's industrial apparatus to the fullest possible extent. But it is important to bear several things in mind. In the first place, other countries besides India are in possession of such Sterling (and Dollar) balances: a new order of creditor-states has been established and it is not possible for the new debtor nations to deal with each case *sui generis*. In the second place, there is a "real" aspect to this question: the whole world will be short of capital-goods. It is true that some of the capital-goods created for war-purposes, e.g., machine tools, will in so far as they are not worn out by excessive wear and tear, be



available for physical transfer. Nevertheless, in so far as India (and other countries similarly situated) demand specified kinds of capital-equipment, it will not, in all probability, be able to supply more than a pre-determined amount in any one year. And even if there were no physical difficulties of any kind, it must also be borne in mind that the amount that can be transferred over the foreign exchanges in any time-period is not indefinite. In the case of the United Kingdom, in particular, the balance of payments position is as yet indeterminate except in one respect: the "invisible" items which have hitherto buttressed the position of the United Kingdom will have shrunk appreciably as a result of the War. To demand an external value of Sterling appropriate to a rapid transfer of India's Sterling balance may conflict very shortly with other aspects of the United Kingdom position. Lastly it must be remembered that if it is desired to use Sterling balances as a means of acquiring capital assets, say from Germany or the U. S. A., the easy interchangeability of currencies must be guaranteed by the post-war monetary mechanism as a whole.

28. It is, of course, extremely easy to lay down *in vacuo* the alternatives which are open to India. Within the bounds of practicability, they are four in number. Firstly, the maintenance of the *de facto* position—i.e., a Sterling exchange standard. Secondly, a dollar standard. Thirdly, a "delinked" rupee, i.e., a completely autonomous rupee. Fourthly, a gold standard. It is worth while to examine the implications of all of these four alternatives, whose attractiveness or unattractiveness cannot be measured in absolute terms. All decisions, on the part of a single country, as to what its currency *ought* to be assumes simultaneous decisions on the part of other countries. One simple illustration will suffice. If the rest of the world were pledged to fixed exchange-rates, whilst India were not, there would be some obvious advantages to be attached to a purely autonomous currency. But, of course, such an assumption is purely gratuitous. India is perhaps the most important, but certainly not the unique case, of a country on the verge of great transitions. It follows inevitably that other countries also might desire to secure the advantages resulting from an autonomous currency. But the generalisation of currency autonomy may very easily rob the whole policy of its attractiveness: *what may pay a single country acting singly may no longer pay that same country acting as one of many, each determined to act without reference to the concurrent action of the others.*

29. Each of the four practicable cases will be examined in what follows, under the alternative hypothesis of the conclusion or the non-conclusion of an international monetary pact. From *this* point of view, it does not greatly matter which plan is accepted, for the essential issues are common to both. By essential issues are meant in this connexion (a) a limitation upon complete autonomy over exchange rates, (b) an element of expansionism and (c) a central direction in monetary policy.

30. First, the maintenance of the Sterling-link on the alternative assumptions stated above. Given an international organisation, it will be possible for Indian held Sterling balances, accruing in current trade to be converted into *bancor* or units, as the case may be: thus the principle of multilaterality will be effectively conserved. It would also be possible to arrange for the conversion of agreed proportions of accumulated Sterling balances into *bancor* and *unitas* having generalised purchasing-power.

The non-conclusion of an international monetary pact would not in itself involve Sterling becoming an unsuitable *international* medium of exchange. But it would decidedly increase the chance that the pressure on the British balance of payments in the post-war period might drive the United Kingdom in the direction of bilateral trade practices. In weighing the desirability of

maintaining the Sterling link, under either hypothesis, the future trend of India's foreign trade must, of course, be kept constantly in mind, for reasons already set out in paragraph 27 above.

31. The second possibility is to link the rupee with the United States Dollar. The United States Dollar will under any circumstances be the strongest currency in the world in the post-war period, and whether formally a gold-standard currency or not, will have a defined gold value. Whether or not any international monetary pact is concluded, the prestige of the Dollar will stand high and higher, perhaps, if no pact is concluded than if it were.

There are three points to be borne in mind. Firstly, India's monetary reserves are at present held in Sterling and to convert any part of them into Dollars, on any significant scale, would require mutual agreement. This would probably be easier if the international situation were eased by the existence of an international pact.

Secondly, it may prove that India's post-war trade will continue to be conducted largely with countries within the Sterling area or with countries whose currency is linked to Sterling. There would thus be no *automatic* connexion between the currency in which it is intended to hold the Central Bank's reserves and the currency-proceeds of the great bulk of India's exports. Provided Sterling were maintained at a fixed value in terms of Dollars, and Sterling were freely convertible into Dollars, this would not greatly matter—but if Sterling were multilaterally convertible and were fixed in terms of the Dollar, the attractiveness of the Dollar as a reserve currency in comparison with Sterling would *ipso facto* also decline.

Thirdly, it is not yet obvious that the long-term purchasing power of the Dollar will, in fact, be greater or more stable than the purchasing power of Sterling. The level of wages and other costs in the U. S. A. does not in fact lend any great support to the suggestion that Sterling is seriously over-valued in terms of the United States Dollar and the dynamic factors at work in the American economy are probably less amenable to control than the same factors are in the United Kingdom, where the dangers of uncontrolled post-war inflation are much more generally appreciated and where political conditions make it easier to enforce anti-inflationary measures. It would not be wise to "plump" for the Dollar without full consideration of this aspect of the matter.

32. The third alternative is a purely autonomous "delinked" rupee. An autonomous currency presents great theoretical attractions, especially in the case of countries largely dependent upon the sale of "raw produce" in international markets, since by means of it the burden of international readjustment is mitigated and the strain is thrown upon the external value of the currency. For these reasons the autonomous currency principle enjoyed high prestige in academic circles in the period of the Great Depression: some of its advocates, however, completely overlooked the fact that the value of such a monetary system, looked at from the point of view of easing the strain of readjustment to price-disturbances, varied in *inverse* proportion to the number of countries *simultaneously* practising the policy,\* at any one

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\* In view of the attention which the theory of an autonomous currency has received in Indian professional economic circles, it is perhaps appropriate that the argument should be stated in technical terms. Given a single country, the advantages of an autonomous currency varies directly with the inelasticity of the world-demand for that country's products and the elasticity of its own demand for imports. But, unless a country possesses a natural monopoly of a range of commodities and its demand for imports is a significant proportion of the total demand for imports, every extension of the system of autonomous currencies will diminish the inelasticity of world demand and increase the elasticity of demand for imports. The contrasting professional views on the matter may be found in Gregory "The Future of the Gold Standard" and S. E. Harris "Exchange Depreciation."

point of time. It is, moreover, impossible to discuss the principle of an autonomous currency in the modern world on the assumption that monetary forces will be allowed to work themselves out to their logical conclusion. Not only will the efforts of country A to throw upon the exchange-rate the burden of adjustment encourage countries, B, C, and D to do the same thing, thus diminishing the advantages to country A, but other consequences will also follow. It is possible to counter currency depreciation, not only by counter-depreciation, but also resort to tariff measures, in the widest sense of the word. Under these circumstances, the theoretical attractions of the policy of currency autonomy encounter serious practical obstacles.

Adhesion to an international pact, were one to come into existence, would of course exclude India from adopting this currency standard, since it is explicit in both the British and the American plans that, subject to the exemptions specifically stated therein, variations in the external value of a country's currency shall be subject to international consent. It is, of course, imaginable that such an international pact might be concluded but that India, on a balance of advantage and disadvantage, might prefer to stay outside the pact, judging that the advantages of an autonomous currency policy outweighed the cumulation of disadvantages, including *inter alia*, the possibility that an international monetary union might decide to permit special measures against countries which attempted to resort to continuous exchange depreciation to safeguard their own position. Lastly, it is, of course, conceivable that no international pact is concluded and that, consequently, every country will be free to choose its own monetary arrangements without having to take into account the consequences to itself of standing outside an international organisation. All that need be said is that if such were to be the post-war monetary arrangements, the outcome to all countries, including India, would be very indeterminate. A new era of currency chaos might ensue, with consequences it is impossible to predict.

33. Finally it is possible to conceive of the rupee being directly linked to gold, in the sense that the rupee would be exchangeable at a fixed price into gold at the Reserve Bank, whilst the holder of gold could acquire rupees (also at a fixed price) by tender of gold to the Reserve Bank. Such a standard has long been demanded by important sections of Indian opinion: the question is firstly, how it would work and secondly, whether it is practicable under the conditions of the post-war world.

As already pointed out in paragraph 15, the place of gold in the world's monetary systems underwent a significant change in the post Depression Period, though the place of gold remained a highly important one. Though from time to time during the War, there have been warnings in scientific quarters that a rational world would not continue to tolerate indefinitely gold extraction at a high cost in terms of other commodities for the purpose of rebuying the same gold elsewhere, this at most is tantamount to a warning that gold purchase prices may have to be revised. There is at present no sign that countries generally are willing to institute fixed parities, in the sense of parities *fixed by law* and intended to be maintained for indefinite periods of time. But it is this fixity and the consequences which follow from it which constitute the essence of the gold standard: if parities are purely provisional (or non-existent, as in the case of the United Kingdom) the resulting currency system is not a gold standard, but a monetary system in which part of the reserves are held in gold and in which gold purchases or sales by the Central Bank are capable of affecting the supply of credit. It is, of course, possible even under an orthodox gold standard to alter the currency value of gold from time to time, but a frequent resort to that device would

being into operation forces—speculation and movements of “hot money” which are likely to undermine, and finally destroy, the standard altogether. From India's point of view, the essential question is not whether the Indian reserves should contain a large proportion of gold—with or without an international pact this would be desirable—but whether it is desirable to maintain fixed parities and an unlimited right to demand gold from the Reserve Bank, as well as an unlimited right to sell to the Reserve Bank. If—in the light of experience—this question is answered in the negative, the case for an Indian gold standard of the orthodox kind goes by the board.

Whatever be the decision arrived at in this regard, it must be noted that the reserve of the Reserve Bank is at present largely held in the form of Sterling, though the existing gold stock, if re-valued at the current price of gold, would bulk appreciably larger. The transition from a Sterling exchange standard to a gold standard would involve the conversion of appreciable amounts of Sterling into gold, and this would not be possible except over a period of time and by arrangement with the monetary authorities in the United Kingdom. Even if, on reflection, it were decided to steer India towards a gold standard, this operation could not take place without international discussion, in which the existence of an International Monetary Authority might play an exceedingly useful part.

34. The immediate issues are these: Firstly, is it to the advantage of India that there should be an orderly arrangement of the world's monetary affairs? The history of the immediate pre-war period shows conclusively that unless there is co-operation in monetary matters, the resulting confusion will strengthen all those forces making for economic isolationism, with resulting political tensions and unnecessary economic impoverishment. Secondly: should India be prepared to join an international monetary organisation? It might, of course, be argued that India could stand outside such an organisation, but yet welcome the formation of such an organisation, if it came into existence as the result of the effort of other countries. But if such an attitude is taken up all-round, no such organisation *will* come into existence. If then, in order that such an organisation can come into existence, it will be necessary for India, as well as for other countries to be prepared to make a common effort, what are the matters upon which her negotiators require to be reasonably satisfied? They are as follows:—

(i) The size of the quota, and, in the event of the American plan being adopted, the form of the deposit,

(ii) The degree to which exchange-variations are permitted and the conditions under which such variations are to be allowed,

(iii) The manner in which, and the extent to which, the multilateral principle will be applied to accumulations, and

(iv) The extent to which effective representation will be given on the governing body of the organisation.

T. E. GREGORY.

The 24th November 1943.