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INDIAN CURRENCY PROBLEMS IN THE LAST DECADE (1926-1936)

Sir Kikabhai Premchand Readership Lectures
Delivered in February, 1937, at Delhi University

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BY

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PREFACE.

The following course of lectures was delivered at the University of Delhi in February this year. In view of the rapid changes in monetary theory and practice in these days, observations on currency soon become out of date. I therefore deeply regret the delay in the publication of these lectures. To avoid further delay, they are published, substantially in the form in which they were actually delivered.

At the time of lectures, numerous charts and tables were projected on the screen with an epidiascope. This explains why the reading matter in some of the lectures which were mainly statistical, had to be cut down, to enable fuller oral treatment of the charts and tables. All those tables and fifteen out of the forty charts have been retained here. The remaining twenty-five charts had to be omitted, much to my regret, in order to ensure the printing of the lectures with the limited funds available for the purpose.

In preparing these lectures, I have been greatly aided by my brother, Dr. H. Sinha, Lecturer in Economics and Statistics, Calcutta University. My debt to him is more than I can suitably acknowledge. Most of the tables were compiled by his pupils, Mr. Deva Raj, M.A., at present Lecturer in Economics, Christ Church College, Cawnpore and Mr. Sudhindranath Sen, M.A., who was also a student of mine at the Presidency College. I have a heavy debt to these two gentlemen, who laid me under further obligation by preparing the charts.

My thanks are also due to my colleague, Prof. P. C. Mahalanobis, and to the staff of the Statistical Laboratory, Presidency College, for the facilities offered in the preparation of the slides for the lectures and for giving me free access to all the journals and other publications in the library attached to the Laboratory.

PRESIDENCY COLLEGE, CALCUTTA. }
| The 15th November, 1937. }

J. C. SINHA.

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LECTURE I.

INDIAN CURRENCY PROBLEMS UPTO MARCH, 1926.

I must thank the authorities of the University of Delhi for appointing me Sir Kikabhai Premchand Reader this year. The subject about which I propose to talk has been the despair of statesmen and administrators in India. It is a subject on which even the economists of the country are not always in agreement. Money now permeates our economic life and touches our pockets in so many ways that problems of currency too often give rise to the most acute and bitter controversy. To quote the remarks of Paul Einzig, "Although the leaders of the monetary reform movement do not literally send each other to the guillotine as the French revolutionary leaders did, in many cases this is not for lack of wishing to do so. For the fight between the various schools, and even between the various factions within the same schools, is at times at least as bitter as it is between monetary reformers in general and their archenemies, the orthodox school."¹ Perhaps difference of opinion is here inevitable, even if we exclude purely personal matter, for a host of political and other non-economic considerations intervene when we want to apply the theories of currency to practice. It would therefore have been more prudent on my part to take up a less controversial topic. But the choice has already been made. I must therefore place my views before you, for what they are worth with a considerable amount of hesitation, avoiding dogmatic statements as far as possible.

Synopsis of the course of lectures.

A brief outline of these lectures may be given at the outset. The present one is introductory. It will seek to analyse the main problems of Indian currency till the beginning of the period of our enquiry. The problems during the year of adjustment from April, 1926 to March 1927 and of the years of comparative stability, roughly from April 1927 to March 1929, will be dealt with in the next four lectures in their different aspects. Statistical description will be given on the basis of both Indian and external data and the economic factors at home and abroad will also be discussed. The strain on Indian currency up to the beginning of the great depression will be the subject-matter of the sixth lecture. The seventh will be devoted to an analysis of the course and phase of the Depression, the two chief currency events of the period,

¹ Paul Einzig—*Monetary Reform in Theory and Practice*, p. vi.

viz., the linking of the rupee to sterling and gold exports, being deferred till the next lecture. The problems during "Recovery and After" will be the theme of the ninth lecture, while some general reflections will be found in the next and the concluding one.

The present rooted in the past.

In my talk to-day the main problems will be treated historically as far as possible, for it is hardly necessary to point out that many of our present currency problems have their roots in the past. A proper appreciation of these is therefore vitally connected with the early history of Indian currency.

It is not suggested of course that our monetary problems to-day are exactly the same as those of our predecessors. Every age has its own economic problems including currency problems, which must therefore be influenced by dominant ideas, especially economic and political, and the prevalent economic structure of the country. Thus the monetary problem in a country with self-sufficient barter economy as the prevailing type of economic organization cannot be the same as that of a country which has a fully developed money economy or credit economy. To quote an instance, multiplicity of currency after the decline and fall of the Mughal Empire with the bulk of the exchange transactions in villages in the form of barter, did not cause such widespread distress as it would have done at the present time. It may however be pointed out that what we now find in India, is not a fully developed money economy but a gradual transition from barter to money economy and from money economy to credit economy. Wages in kind, paddy loans and grain rents, though less common, have not yet disappeared from rural India.

The problem of the rupee.

It may however be contended that the main constituents of our currency to-day are rupees, notes and bank money, whereas rupees were the only form of currency in pre-British days. As is well-known, indigenous banking in India did not evolve any system of deposit currency or of bank notes. Though China had paper money as early as the ninth century A.D., it is rather surprising that India had no such currency before the advent of the British rule. But even now, notes and bank money are not of preponderating importance in our currency system. In fact both in point of time and in the amount of money-work done, the rupee is still relatively much more important. It has a long history extending over some seven hundred years, from its inception in 1233 A.D. to the present day while our paper currency is hardly a century old. Thus the central problem of Indian currency has so far been the problem of the rupee. This has given rise to various difficulties in different periods of our economic history.

Instability.

Thus, to speak quite broadly, one of the earliest problems of the rupee was the problem of exchange stability in terms of foreign currencies,—a problem which has not been satisfactorily solved even now. By linking the rupee to depreciated sterling in September, 1931, we have lost stable exchange rates not only in terms of gold but also in relation to other depreciated currencies like yen.

A similar problem faced the early British administrators in India. In Mughal times, although the revenue was reckoned in copper *dams*, the silver rupee formed the chief currency of the country. *Mohurs* were struck mainly for making presents and for receiving tributes, but no legal ratio was fixed between gold and silver. It was in southern India alone that gold *hun* or *pagoda* was the standard coin. Though the Mughal rupee remained practically unchanged in weight and purity for some two hundred years from the accession of Akbar till the death of Muhammad Shah, there was no complete uniformity of currency even under the strongly centralised rule of Akbar and his three immediate successors, because the rupees struck even by the same Emperor in different years were treated as different species of coins. If that was so when Mughal India was more or less a single economic unit, it is no wonder that uniformity of currency disappeared altogether on the break-up of the Empire after the death of Aurangzib. The different provincial rulers then became practically independent and began to strike their own coins as the easiest and most incontestable emblem of sovereignty. The problem of conversion of *Sicca*¹ rupees of Bengal into, say *Vizier* rupees of Oudh thus became identical with the present problem of converting rupees into Japanese yen or German marks. For Indian currency during the latter half of the eighteenth century was in no less a chaotic state than the different currencies of the world at the present time with its inflation, reflation, deflation and devaluation. For instance, "in 1773 there were circulating in various parts of India 139 kinds of gold *mohurs*, 61 kinds of gold *huns* or South Indian coins (called *pagodas* by Europeans), 556 kinds of silver rupees, besides 214 kinds of foreign coins."² In Bengal, the condition of currency was perhaps worse. Gradually different species of rupees became the established currency in the different parts of the province as shown in the following table, com-

¹ *Sicca* rupee (from Arabic *sikka*, a coining die) means a newly coined rupee of a certain weight and fineness which was the standard money in Bengal during the eighteenth century. 100 *sicca* rupees=116 current or *chamani* rupees. The current or *chamani* rupee was not a coin at all but a mere money of account.

² Sir Jadunath Sarkar—*Economics of British India* (4th Edn., 1917), pp. 287-288.

piled from contemporary official records¹:—

Parts of Bengal.	Species of rupees.	Used for.
Dinajpur.	(1) Sonauts ² of different suns ³ (2) English and French Arcots. ⁴ (3) Sonauts but the buyer leaves (?) (this portion of the record is illegible) half-an-anna batta. (4) French Arcots ..	Rice and other grains. Ghee, jaggery, etc. Cloth. Hemp, gunnies, etc.
Purnea ..	Patna Sonauts.	
Nadia ..	Siccās.	
Rungpur ..	French Arcots. The revenues were collected in Narayan's rupees.	
Birbhum ..	Murshidabad Sonauts.	
Malda ..	Murshidabad Sonauts.	
Hugly ..	Siccās.	
Ghoraghat (a district in North Bengal).	(1) Siccās. (2) French Arcots. (3) Murshidabad Sonauts.	Rice and other grains chuna, cocoanut, etc. Cloth, salt and betel nut. Sugar and jaggery.
Jessore ..	(1) Siccās. (2) Murshidabad Sonauts. (3) French Arcots.	Rice, grain, betel-nut, sugar and jaggery. Cloth, ghee, oil, long-pepper, turmeric, etc. Salt.
Bishnupur ..	(1) Sonauts. (2) Old Dushmasha. (3) Arcots. Murshidabad Sonauts.	Grain, bamboo, jaggery, etc. Oil, ghee, brass and other metals. Cloth.
Futty Sing, Khergong Bar-bucking, and Cutlabpore. Chandelhey (comprising portions of present Mal-dah and Rajshahi districts).	(1) Siccās. (2) Dushmasha ⁵ .	Grain, bamboo, ghee, oil, jaggery and sugar. Cloth, brass and other metals.

¹ O.C. (Original Consultations) 3 (b) April 12, 1770, I.R.D. (Imperial Record Department of the Government of India).

² The word is properly *sanaut*, plural of Arabic *san*, a year. *Siccās* and *sonauts* were new and old coins of the same species. During the third year's currency, and ever after, the value of *siccā* rupees was reduced by about 5 per cent. They were then called *sonaut* rupees and circulated at the rate of 100 *sonauts* to 111 current rupees. This practice of charging a discount on the coin, according to the period for which it had been in circulation, must have arisen to prevent worn-out old coins from replacing the newly coined ones in circulation.

³ i.e., years.

⁴ The *arcot* rupee was originally struck by the Nawab of Arcot in the Madras Presidency. By 1740, the English, the French and the Dutch had secured the privilege of coining this rupee. The rupees coined by these three European nations came to be known as English, French and Dutch *arcots*.

⁵ Named after Nar Narayan, a famous king of Cooch Behar.

⁶ Rupee weighing ten *mashas* or about 150 grains (troy). In 1772, 100 *Dushmasha* rupees were equivalent to 110 current rupees.

The Indian table for weighing gold and silver is as follows:—

8 *ratīs* = 1 *masha*, 12 *mashas* = 1 *tola* or 180 grains (troy).

Ratī—the weight of the seed of *Abrus precatorius*, varying in weight from 1.75 to 1.96 grains (troy).

Parts of the Bengal	Species of rupees.	Used for.
Barbezu (greater part of the present district of Mymensing).	French Arcots.	
Atteah (Sub-division north of Dacca).	(1) French Arcots.	Grain, ghee and oil.
Pachette	(2) English Arcots.	Cloth.
	Vizieri and Benares rupees.	
Dacca and Tipperah	French and English Arcots.	
	In the city of Dacca its own Siccas were current.	

✓ Thus not only were different kinds of rupees in circulation in different districts but even in the same district different commodities had to be exchanged with different kinds of rupees. A greater chaos in currency cannot be imagined.

Batta.

It is no wonder therefore that the mutual conversion of these diverse coins was an exceedingly complicated problem. Indigenous bankers charged high and arbitrary *batta*,² against which there was naturally great resentment on the part of European traders. On the other hand, coins were often debased and worn out and could not be accepted at the original rate. This will be clear from the following two tables compiled from the contemporary records of the English East India Company:—

O.C. No. 5, 12th March, 1790³ (I.R.D.)

Account of the rates of Value of the different Sorts of Gold Mohurs Current at Moorshedabad, as delivered by Purmanund, Son of Sunghet Ram Chowdry Shroff and Hurrey Sing Choukussey, Son of Roy Sing Choukussey of Mehajentooley, Specifying each Specie and its weight, etc.

Species.	Weight of each Gold Mohur, calculated at 10 Massah, 7 Rutty and $\frac{1}{2}$ Jow p. Sicca weight.			Rate of Gold Mohur in purchasing Sa. Rs.	Rate of Gold Mohur in selling Sa. Rs.
	Massah	Rutty	Jow		
Stamped at Delhy:—				Rs. as. G. ⁴	Rs. as. G.
Akburry ⁵	9	5	..	14 3 0	14 4 0
Shajahaney ⁶	9	5	..	14 1 0	14 2 0

¹ Vizieri rupees were the rupees struck by the Vizier or Nawab of Oudh.

² i.e., discount.

³ In this extract from the manuscript records of the East India Company, the actual spelling and the use of capital letters have been adhered to, as found in the original.

⁴ "G" stands for "gundas", 20 *gundas*=1 anna, 16 annas=1 rupee.

⁵ i.e., struck during the reign of Emperor Akbar, 1556-1605 A.D.

⁶ i.e., struck during the reign of Emperor Shahjahan, 1627-58.

O.C. No. 5, 12th March, 1790 (I.R.D.)—(Contd.)

Species.	Weight of each Gold Mohur, calculated at 10 Massah, 7 Rutty and $\frac{1}{2}$ Jow p. Sicca weight.			Rate of Gold Mohur in purchasing Sa. Rs.	Rate of Gold Mohur in selling Sa. Rs.
Stamped at Delhi:—	Massah	Rutty	Jow	Rs. as. G.	Rs. as. G.
Mehomed Shye ¹	9	5	..	14 3 0	14 4 0
Aurung Shye ²	9	5	..	13 12 0	13 13 0
Aumed Shye ³	9	5	..	13 9 0	13 10 0
Stamped at Patna:—					
Mehomed Shye	9	6	..	13 9 0	13 10 0
Aumed Shye	9	6	..	13 8 10	13 9 10
Norung Shye Panchmail ⁴ —					
Stamped at Cuttuck, Jehangirnagar, ⁵ Patna and Moorshedabad.	9	6	..	13 10 0	13 11 0
Stamped at Ellabad (i.e., Allahabad), Goruckpore, Mooltaun, Muttrah, Augra, Korrah, Beejoypore ⁶ and Joynagur ⁷ .	9	5	..		
Mehomed Shye Panchmail—					
Stamped at Cuttuck, Jehangirnagar, Patna and Moorshedabad.	9	6	..	13 4 0	13 5 0
Stamped at Ellabad, Goruckpore, Mooltaun, Muttrah, Augra, Korrah, Beejoypore and Joynagur.	9	5	..		
Stamped at Benares —					
Mehomed Shye.	9	5	..	13 4 0	13 5 0
Stamped at Hyderabad—					
Mehomed Shye	9	5	..	13 3 0	13 4 0
Stamped at Surat—					
Mehomed Shye.	9	5	4	13 3 0	13 4 0
Stamped at Arcot—					
Old Mehomed Shye.	9	4	6	12 8 0	12 9 0
Stamped at Arcot—new Aulumgeeray ⁸ and Gohur Shye ⁹ .	9	4	6	12 4 0	12 5 0
Stamped at Moorshedabad and Calcutta—Gohur Shye Sicca Gold Mohur.	10	7	$\frac{1}{2}$	14 12 10	14 12 10

Zilla Moorshedabad, the 5th March, 1790.

O.C. No. 6, 12th March, 1790.

Account of the Rates of value of the different Sorts of Rupees Current at Moorshedabad, as delivered by Purmanund, Son of Sunghet

- ¹ i.e., struck during the reign of Emperor Muhammad Shah, 1719-48.
- ² i.e., struck during the reign of Emperor Aurangzib, 1658-1707.
- ³ i.e., struck during the reign of Emperor Ahmad Shah, 1748-54.
- ⁴ Coins of various kinds struck during the reign of Emperor Aurangzib. 'Panchmail' means of various kinds. 'Norung Shye' is the same 'Aurung Shye'.
- ⁵ Jehangirnagar (i.e., Jahangirnagar) is the old name of the town of Dacca in East Bengal.
- ⁶ i.e., Bijapur in the Deccan.
- ⁷ Joynagur is another name of the town of Jaipur in Rajputana.
- ⁸ i.e., struck during the reign of Emperor Alamgir II, 1754-9.
- ⁹ i.e., struck during the reign of Ali Gauhar, who took the title of Shah Aillam II. 1759-1806.

Ram Chowdry Shroff and Hurrey Sing Choukussey, Son of Roy Sing Choukussey of Mehajentooley, specifying each Specie and its weight, etc.

Species.	Weight of each Rupee calculated at 10 Massah and 2 Ruttey p. Sicca weight.			Rate of Rupee in purchasing in Sa. Rs.	Rate of Rupee in selling in Sa. Rs.
	Massah	Ruttey	Jow		
Stamped at Moorshedabad— Sunna Mooktallif ¹					
11 Sun ..					
12 Sun ..					
Sicca 15 Sun ..	10	2	..	1 0 0	1 0 0
19 Sun ..					
Stamped at Moorshedabad— Sonat 10 Sun.	10	2	..	1 9 0	1 7 0
9 Sun ..	10	2	..	1 5 0	1 3 0
Sonat Fooley ..	10	2	..	1 10 0	1 8 0
Sonat Sabick ..	10	2	..	1 12 0	1 10 0
Stamped at Jehangirnagar—Sonat.	10	2	..	2 14 0	2 12 0
Stamped at Patna—Sonat ..	10	2	..	1 6 0	1 4 0
Arcot English Poorah ..	10	2	..	7 0 0	6 14 0
Velayty ..					
Arcot French ..	10	2	..	3 7 0	3 5 0
Arcot Dhukey Ghur ..	10	2	..	7 13 0	7 11 0
Dhukey Cauchet ..	10	2	..	9 0 0	8 14 0
Panchmail Hurzerb ² ..	10	2	..	4 12 0	4 10 0

Zilla Moorshedabad, the 5th March, 1750.

A similar state of things is found in China at the present time. In consequence of diversity of currencies, special exchange shops abound in the larger Chinese cities. They are so numerous that they constitute a formidable vested interest opposed to simplification and unification of currency. The lucrativeness of the trade is indicated by the well-known Chinese adage that ten exchanges eat up one's capital.³ In modern times also, on account of the depreciation of currency in many countries, there has been a change not only in their gold value but also in their command over goods and services, although the original name is retained. Thus yens in 1930 were not the same as the yens of 1932. In other words, the problem of *batta* in the days of John Company has reappeared in our days in a no less acute form.

¹ i.e., of various years.

² Hurzerb=*har zarb*, i.e., struck anywhere.

Panchmail Hurzerb therefore means 'coins of various kinds struck anywhere'. These rupees were very much debased. Though they had the same weight as the sicca rupee yet they had only about one-fifth of the value of the latter.

³ T. J. Krep's article "The Price of Silver and Chinese Purchasing Power" in the *Quarterly Journal of Economics*, February, 1934.

Travail of bimetallism.

Not only is there a general similarity between *batta* and exchange rates, there is also a close parallel in some of their special aspects. The complicated problem of fixing the correct exchange rate is not a new problem at all. In early Anglo-Indian days, numerous attempts were made to fix the gold value of the rupee under the auspices of bimetallism. In other words, the *batta* for the conversion of gold *mohurs* and *pagodas*¹ into rupees was sought to be fixed by Government. Thus there were three successive attempts at bimetallism in Bengal in 1766, 1769 and 1793. On all these occasions, the rupee was undervalued in terms of gold, and the par of exchange between the gold mohur and the silver sicca rupee, as fixed by Government Regulations, broke down, in spite of all the stringent measures against shroffs who were made the scape-goats of currency blunders on the part of Government just in the same way as speculators in exchange in our more enlightened days. The Government of Madras erred on the other side and overvalued silver in their schemes of bimetallism in 1749, 1790 and 1797. Bombay Government on the other hand in their bimetallic plans during the latter half of the eighteenth century overvalued gold, though not to the same extent as in Bengal, but with no better result.

This problem of overvaluation and undervaluation of the rupee in terms of gold in the eighteenth century finds an interesting parallel in the demand for 15 penny rupee before the Fowler Committee and 16 penny rupee before the Hilton Young Commission. But there is this difference that in the eighteenth century, the disparity between the official and market rates corrected itself by driving the undervalued metal out of circulation. Just as in the 18th century England passed from silver to gold currency by an accidental overvaluation of the yellow metal, similarly about the end of the same century Madras passed from gold to silver standard, through the overvaluation of the rupee. Such transition is however difficult and protracted to-day. In the absence of bimetallism, it can be achieved only through a slow and painful process of deflation. Even that is not possible if the overvaluation is considerable or the economic structure very rigid.

In the second place, apart from deliberate overvaluation by Government, changes in the relative market values of gold and silver were partly responsible for the acuteness of *batta* in early British days. Thus the first Currency Committee in this country, that of 1787, appointed by Lord Cornwallis, ascribed the rapid increase of *batta* for exchanging mohurs into rupees, not only to the official overvaluation of gold but also to seasonal stringency of silver. The evil however continued. Ten years later, Sir John Shore in his Minute of September 29, 1796,

¹ Gold *hunn*, weighing about 52 grains (called *pagodas* by Europeans) was the standard coin of South India hence the phrase "shaking the pagoda tree". These *pagodas* were also of diverse kinds, varying in weight and purity.

referred to the periodic increase of *batta* in summer when rupees were drained to mofussil centres as advances to artisans. On the other hand, the permanent changes in the relative market values of gold and silver, caused serious difficulty to the currency authorities of India during the last quarter of the nineteenth century and during the war and post-war periods of the present century. The fall in the gold value of silver which began in the seventies and continued till the end of the nineteenth century was solved by the adoption of gold exchange standard, or rather a sterling exchange standard in 1899. When this broke down during the War period, mainly on account of a rise in the gold value of silver, the Hilton Young Commission recommended a curious mixture of gold bullion and gold exchange standards, as a solution of the problem. The early Anglo-Indian administrators proposed a remedy similar in its essential feature, although differing in details. They suggested silver monometallism which was adopted for the whole of British India in 1835.

This could not however be done towards the close of the eighteenth century, for as pointed out by Sir John Shore in 1796, there was the difficulty of converting into rupees at the official rate before the appointed date, gold coins already in circulation, which would "be thrown upon the Treasury". Almost the same argument was used by the Hilton Young Commission 130 years later when they rejected the scheme for a gold currency, mainly on the ground that the conversion into gold of a substantial portion of rupees in circulation and in hoards during a definite period, after which the rupee would cease to be unlimited legal tender, would give rise to serious difficulties.

Thus one great problem of Indian currency has always been the question of the standard. It has just been said that from silver standard, we passed on to gold exchange standard or rather to sterling exchange standard. This was replaced by a curious mixture of gold bullion and gold exchange standard in 1927. From this we have again moved on to sterling exchange standard. But in the midst of all these changes, the rupee still maintains her predominant hold on our currency system, more or less unimpaired. Though her powers were considerably restricted in 1893, she still refuses to abdicate and the question of dethronement of the rupee, *viz.*, the limitation of its use to small transactions, has not yet been given effect to.

High interest rates.

Another defect of the Indian monetary system is high money rate. This has been with us from early days because until quite recent times both the subjective and objective conditions for the growth of capital, were practically non-existent in India. In the eighteenth century, there was hardly any market for long term loans. Purchase and sale of Government securities were then extremely limited. It was no wonder

therefore that their value was so unstable. Any rumour, political or financial, completely upset the price of Government securities. Thus when Cornwallis came to India in 1786, the East India Company's bonds bore a discount of 25 per cent. On September 30, 1789, they sold at par and even commanded a small premium. Four months later, they sold, when they could be sold at all, at a discount from 10 to 12 per cent. The market for long term money was then so restricted that loans had to be raised through lotteries for local purposes.

We have not travelled very far from this state of affairs. It is true that a new market for ordinary shares has now been developed with the recent industrialisation of India, but it is equally true that preference shares, debentures and other bonds which are largely utilised in other countries for raising long term funds are not so common in this country. The result is that even now the market for fixed interest-bearing bonds is practically restricted to securities issued by Government and local bodies. Another reason for this lack of development of the long term capital market is the backwardness of Indian agriculture and industries. Fragmentation and smallness of holdings, complexities of land tenure and above all, the chronic indebtedness of the ryot make the employment of long term capital well-nigh impossible in agriculture. The market for short term funds is also not properly organized. The high short term rates of interest is a more serious defect in our present monetary system.

Seasonal stringency.

Reference has been made above to seasonal rise in the rate of *batta* during early British days when funds were remitted to *aurungs*¹ to finance the Company's 'investments'.² In those days crop-moving funds were hardly required, the crops being consumed mostly where they were produced, partly because of the self-sufficient nature of economy at the time and also because of the difficulty and expense of transport. But the problem was essentially similar to the problem of seasonal stringency at the present time. The remedies adopted in the eighteenth century to mitigate the evil, bear also some similarity to the measures introduced in our days. Under the Paper Currency Acts of 1920 and 1923 and the Reserve Bank Act of 1934, the currency authority has been empowered to issue additional currency notes in times of seasonal stress. What Sir John Shore proposed in 1795 was that half of each government disbursement in Calcutta during the months of seasonal stringency should be in gold, in order to reduce the pressure on silver.³

¹ Depots of manufacture.

² Purchases of goods by the East India Company for exportation to Europe.

³ It may be noted here that the coinage of gold sovereigns in India which had been recommended by the Fowler Committee in 1898 but was indefinitely postponed, had to be undertaken in 1918-19 to supplement the shortage of silver rupees. The Branch of

Gold currency was then expected to do the work which currency notes are now doing. It is interesting to note that gold currency was advocated by the European Chambers of Commerce in India in the sixties of the last century mainly with the same object in view. Another measure adopted towards the close of the eighteenth century, *viz.*, the provision of silver in district treasuries in anticipation of the usual season of scarcity, has a striking resemblance to the great development of the system of currency chests at sub-treasuries, enabling rapid and economical transfer of funds from upcountry stations to headquarters and *vice versa*.

Internal remittance.

The best remedy for seasonal stringency is mobility of funds. The great, almost bewildering, diversity of currency in different parts of the country during the early British days, made it almost impossible for the coins of one area to serve the currency needs of another. As late as 1840 at Mirzapur in the United Provinces, "the coinage was so debased that it took a whole day to count a few thousand rupees," as reported by Sir James Brunyate, who refers to the use of sealed bags containing 1,000 rupees which passed freely from hand to hand without being opened or counted. This not only obviated the necessity of frequent conversion and reconversion but also supplied to some extent the need for currency notes of high denomination. In the second place, transport was so slow and so unsafe that the movement of funds was a serious problem. It is true that *hoondies* of indigenous bankers formed a regular machinery for remittance of funds even in far off Hindu times. But in the transition from the old to the new order during the latter half of the eighteenth century, indigenous banking was very seriously affected. Some of the early European bankers in India tried to introduce a system of bank post bills for the purpose of remittance as a precaution against highway robbery, but their attempt proved abortive. It may be recalled in this connection that the Indian Central Banking Inquiry Committee hopes to bring indigenous banking within the fold of organised banking partly by offering cheaper remittance facilities, in addition to rediscounting advantages. This shows that even now the problem of internal remittance remains fairly acute.

Transfer problem.

Recent gold exports from India have been sought to be justified on the ground that gold was practically the only commodity available for meeting our foreign obligations. Various devices, quota arrangements, exchange clearing systems have been adopted in different countries to adjust the balance of payments in view of falling exports in

the Royal Mint established in Bombay for the issue of sovereigns was closed in April, 1919.

recent years. In the early Anglo-Indian days, specially after the battle of Plassey, considerable remittances had to be made abroad through gold, silver and diamonds as is generally well-known. What is not generally known however is that forced exports were sent on a much wider scale than even gold and silver, not to speak of diamonds, for effecting transfer of funds abroad. In their anxiety for remittance to England, the East India Company were obliged to sell their exports at a loss, generally with the exception of cotton piecegoods. Even those exports had to be carefully collected through a system of upcountry *aurungs*. Our position with regard to this transfer problem is even now unsatisfactory. For even to-day our exports consist of a few articles subject to great variations in prices,—a weakness in our economic system, rudely revealed by the last depression, calling for large export of gold.

Objective of currency policy.

With regard to the objective of currency policy also, we have not travelled far from early Anglo-Indian days. Even now there is hardly any unanimity among economists as to what should be the goal of currency policy. Should we aim at mere stability of exchange or at stabilisation of the wholesale index number of prices, as we had from 1921 to 1924? Or should our ideal be stabilisation of prices in terms of consumption index number of prices? Should we aim at economic stability or as Keynes argues, should the proper aim of monetary policy be full employment? Should the objective of currency policy be the same as that which constitutes economic progress, *viz.*, the increase of average real income? It will be discussed in the concluding lecture that the only ideal which is attainable in India at present and also in the near future is stability of exchange. This was also the ideal of the currency administrators in the days of John Company, though the term 'stability of exchange' in those days meant stable rate for the conversion of the standard rupee into diverse kinds of rupees, then in circulation.

Currency control and administration.

In the matter of currency control and administration also, many of the recent proposals were anticipated at the beginning of the British rule. Thus as early as 1772, Sir James Stuart, the last of the English mercantilists suggested that India's currency problem was at bottom a banking problem which could be solved by starting a bank like the Bank of England. It was to issue notes and discount bills and was to have branches in different districts. It was to be "regulated by the East India Company" but was to remain a private institution, for, according to Sir James, "the principle upon which this branch of credit is grounded is totally incompatible with sovereign powers"—a principle which has been accepted in this country after so much controversy in the Reserve Bank Act of 1934.

One of the objects which the Reserve Bank of India is expected to achieve in the near future is the provision of cheap remittance facilities. It is interesting to note that as early as 1773 Warren Hastings proposed the starting of a bank under Government patronage with the same object in view.

Other instances may be given but it is no use multiplying them. Sufficient has been said above to show that the old problems still remain with us, possibly in a somewhat modified form. This must be so, for they are inherent in our economic system. Not that our economic life remains exactly the same as it was in the past. There has been a change, on evolutionary, rather than on revolutionary lines. An endeavour will be made in the next few lectures to trace the currency events in the last decade and consider how they influenced and were influenced by the changing economic structure of India.

LECTURE II.

PERIODS OF ADJUSTMENT AND OF COMPARATIVE STABILITY (1926-29): INTERNAL EVIDENCE.

In the last lecture it was pointed out that the central problem of Indian currency was that of the rupee which gave rise to a series of problems in the past, the most important of which were the questions of the standard and of exchange stability. Closely allied to the latter was the problem of overvaluation and undervaluation of the rupee. The questions of seasonal expansion and contraction of currency, of high short term and long term rates of interest, of internal remittance and of export surplus were some of the other perplexing problems.

What does 'stable period' imply?

The search for a solution of these and others began long ago and was continued up to the beginning of the period of our study. The next decade may roughly be divided into a number of periods as stated in the previous lecture. It is proposed to discuss to-day two of such periods, the first being that from April, 1926 to March, 1927, which has been described here as the period of adjustment. It is not suggested however that the adjustment occurred only during this period. In fact it began long ago as will be shown in the next lecture. The year under consideration covered only the final stages, which was followed by a period when the adjustment was as complete as possible in the disordered state of the post-war world, extending over the next two years, roughly from April, 1927 to March, 1929, which I have ventured to call the period of comparative stability. During these two years the various phases of economic activity in this country were relatively more stable than in any other period after the War. It is not of course implied that the entire range of these two years was free from all changes whatsoever. For all economic phenomena apart from random changes, are subject to three sets of influence, *viz.*, (a) secular trend, (b) cyclic, and (c) seasonal fluctuation. In a big agricultural country like India, seasonal fluctuations are very wide, as already pointed out. There can be no period in Indian economic life during which they are entirely free. During the last decade population expanded by a considerable amount. Production increased, partly through expanding economic life and partly through tariffs. It is no wonder therefore that secular trend affected different economic series to a large extent. By comparative stability we mean comparative freedom from trade cycles and their repercussions on economic life.

It is clear therefore that if costs and prices are in mutual adjustment during any period, that period should be regarded as one of internal

stability. During such a period, the range of profits is just sufficient to maintain the existing level of production. This is a necessary but not a sufficient condition. For, we are not considering a closed system and we have to estimate how far external factors upset our internal economic equilibrium.

This fact is recognized by the Hilton Young Commission who have shown that there was a high degree of correspondence between prices in India and world prices both in terms of gold. They have drawn the conclusion that "substantial equilibrium was attained (in India) about the middle of 1925 and has been since maintained." (H. Y. Report, p. 70.) Their method of showing correlation between world and Indian prices, is far from satisfactory. For wholesale price index numbers, all the world over are rough approximations to international index numbers, composed of prices of internationally traded goods which must command nearly the same price throughout the world.

External equilibrium.

For external equilibrium, to use Keynes's phraseology, foreign balance must equal foreign lending and there should be neither import nor export of gold, including 'ear-marked' gold. In the peculiar conditions of India, there is normally an import of gold which should therefore be treated in the same way as an import of ordinary merchandise. It is only when a large change in such import persists for some time, one may suspect external disequilibrium.

The other condition requires approximately the same yield of interest on capital in the country concerned and outside, after making allowance for risks of transfer and investment. In the second place, there should be approximately the same price level of internationally traded goods at home and abroad after making allowance for changes in tariff and transport charges. It is only this last condition that has been examined by the Hilton Young Commission.

Internal equilibrium.

It has been stated above that internal equilibrium means a parity between cost of production and price level. The particular price level which we have to take into account, is what is obtained by producers. In other words, the appropriate price level is measured by the index number of wholesale prices, for which we have a fairly satisfactory series, *viz.*, Calcutta wholesale index number. It is not of course implied that this index number is free from defects as regards the selection of the base year, the items of commodities included and so on. For example, July, 1914, which is still the base year of all the recent wholesale index numbers in India including Calcutta index number, appears to be out of date. A more satisfactory post-war base period should therefore be

selected. It has also not been ascertained whether the relative importance of different articles included in Calcutta and other wholesale index numbers, has not changed in recent years as compared with the state of things in 1914. This is necessary, for in the case of countries like the United Kingdom where a census of production is held, there are large and substantial changes in net outputs, which define the relative weights. It is true that we have as yet no census of production to guide us in this matter, but in any case it appears that the number of articles quoted in Indian index numbers is rather too few.

Wholesale price level.

It may however be pointed out that of all the wholesale index numbers so far published in India, Calcutta wholesale index number is the least unsatisfactory. With its 72 price relatives calculated for 45 different commodities, it is more representative than Bombay wholesale index which consists of 44 price relatives and refers to 30 different commodities. Karachi wholesale index number with 28 price relatives and comprising only 29 different commodities, is far less representative. Sir Purshotamdas Thakurdas in his Minute of Dissent to the Hilton Young Commission prefers Bombay wholesale index on the ground of "the predominance of jute and tea in the Calcutta index number". To this it may be said that the Bombay index is also heavily weighted with cotton and cotton manufacture. Our reason for using Calcutta index rather than Bombay index is based on the fact that jute, jute manufacture and tea figure more prominently in the export trade of India than cotton and cotton manufacture. Sir P. Thakurdas also mentions marked fluctuations in jute prices during 1925-26. This is by no means an unmixed evil. The price of a packing material like jute, even though fluctuating, has a far greater claim for inclusion in an index number of the international type,¹ apart from its importance in the national economy of India. The method of weighting followed is obscure in all the three cases. But the price quotations for the Calcutta index seem to be derived from a wider and more representative market than the others. Apart from these, both in the case of Bombay and Karachi index numbers, when the price quotation of a commodity is not available, the last available quotation is repeated, without any correction whatsoever. For example, in Bombay wholesale index number for September, 1936, quotations for April, 1935, October, 1935, and April, 1936, have been repeated in the case of some articles. But it is desirable that such quotations should be corrected by allowing for them the same change in purchasing power which is found in the case of other articles forming the same group of commodities. In

¹ It is true that for comparisons of price levels in different countries, this index number is quite suitable, whereas for estimating the disparity between prices and costs in the country, we should have an index number which gives due weight to goods and services of internal importance. From this point of view also there is not much to choose between Calcutta and Bombay indices.

case there is only a single quotation for a particular commodity, the latest available quotation should be corrected by adding to or subtracting from it, the same percentage change which is noticed in the case of all other commodities forming the index number. Such corrections are made in compiling Calcutta wholesale index number. For all these reasons, this index number alone has been used in these lectures for showing the general movement of wholesale prices in India. The Department of Statistics index number with its base year of 1873, is sadly out of date for serving any useful purpose.

The level of costs.

As regards costs, satisfactory data are not available even in western countries, in India such data are conspicuous by their absence. Taking profits as the excess of selling price over costs, the main elements of costs are (a) the cost of the raw material, (b) wages, (c) salaries, (d) cost of depreciation of plant, and (e) interest charges. An estimate based on the census of production of the United Kingdom (1930) shows that in conditions of economic equilibrium, about 50 per cent. of the cost of production in Great Britain is due to the cost of raw materials. A corresponding figure for India cannot be estimated in the absence of a regular census of production. It is clear however that the ratio of the cost of raw materials to other costs varies widely in different types of industry. It is equally clear that the cost of raw materials does not move *pari passu* with the price of the manufactures. In the case of wages also, the proportion they bear to the total cost of production differs from industry to industry even in the same country. Thus in coal mining, wages form a larger portion of total cost than in railway transport, where capital cost is proportionately larger. Not only this, on account of changes in organisation such as the extent of capitalisation, etc., even for the same industry the proportion of wages to total cost varies from time to time. This difficulty is enhanced when we remember that wages are not sufficiently flexible even in countries without strong trade unions. There is no guarantee therefore that wages move in the same proportion either as the cost of production or as the price of finished goods.

Statistics of wages.

Thus we are unable to neglect the effect of wages, which form one of the important elements of costs. Unfortunately statistics of wages in India are meagre and very unsatisfactory. The report on "Prices and Wages in India" was discontinued from 1924 partly for reasons of economy and partly because the data were mostly incomplete and inaccurate. We have therefore to fall back upon the provincial factory administration reports, tariff board reports and agricultural wage census reports. These cannot give us a full and accurate account of wages in India. Even for a province like Bengal administered by a regular staff of factory inspectors, statistics of wages are very unsatisfactory, to say the

least. The following extra from the *Annual Report of the Working of the Indian Factories Act in Bengal and Assam* for the year 1926 will reveal the situation :—

"These figures can serve no useful purpose other than a comparison of wages earned by different classes of labourers and an indication of their level . . . The figures . . . not being based on substantial and exhaustive information are of little value for comparison with previous years' figures. Moreover, no attempt has been made to value the free housing, medical attention and other amenities provided . . ." (p. 4).

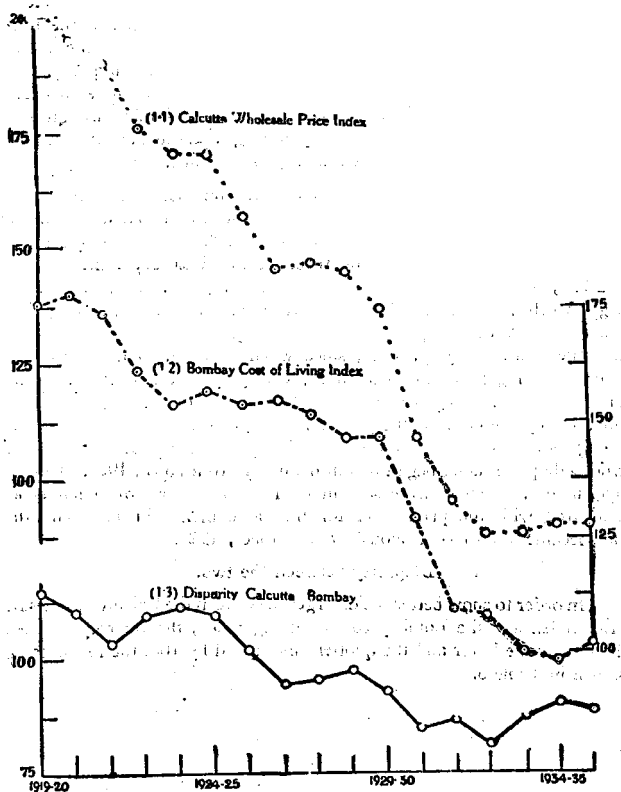
The situation has not improved since then. Even now we find the same wide disparity between the maximum and minimum wages of operatives not properly graded up, e.g., Rs. 6 to Rs. 17—8 as. in the case of carpenters employed in non-textile factories. The other elements of cost of production are equally elusive. It is therefore not possible to judge directly how far the cost of production has moved *pari passu* with prices during the period of our study. At the Ottawa Conference, 1932, Sir Henry Strakosch stated that "the cost of living index is a good index of the general cost of production in a country". His reasons were made clear in a subsequent memorandum on the "Road to Recovery" published in the *Economist*. In the first place, he showed that the proportion of flexible to rigid items was the same both in the cost of living index and in the cost of production. In the second place, he found out that the two had the same trend. He concluded therefore that although one was not a measure of the other, it could be utilised to show the general movement of the other with reasonable accuracy. Sir Henry Strakosch does not refer specifically to the case of India. Nor in the absence of a regular census of production has it been possible to calculate the cost of production for India, and study to what extent its fluctuations were similar to those of the cost of living index.

Wholesale price level and cost of living.

Bearing in mind this limitation, the movements of Calcutta wholesale index number and of Bombay cost of living index number and disparity between the two are shown in Chart I.¹ It indicates roughly the relation between costs and prices in India.²

¹ Chart I is a log curve, i.e., a logarithmic curve. It is simply this that instead of plotting the index numbers on the ordinate side, as is usually done, the logarithms of those numbers have been plotted. Thus 10 has been 1, 100 has been represented by 2 and so on. Unless this procedure was adopted, it would have been impossible to show the wide range within such a small compass. During 1919-20 the wholesale price index stood at 202, whereas it dropped to 88 during 1932-33 and 1933-34. Such wide variation can be represented adequately only in a logarithmic chart.

CHART I (LOG CURVE). CALCUTTA WHOLESALE PRICE INDEX (1.1).
BOMBAY COST OF LIVING INDEX (1.2), DISPARITY, CALCUTTA;
BOMBAY (1.3)



The topmost curve in Chart I shows the movement of Calcutta wholesale index number. It fell continuously from 1919-20 to 1926-27, followed by a period of comparative stability, after which there was a heavy decline. The Bombay cost of living index number which is the second curve, exhibits similar movement but the movement is not exactly similar. For if one looks closer, it will be seen that the

fall since 1919-20 was steeper in the case of the wholesale index than in the case of the cost of living index. In other words, the gap between the two curves was not uniform throughout. To bring out the relative movement of the two better, the former has been expressed as a percentage of the latter and this disparity is shown in the third curve. The wavy nature of this curve shows clearly that the wholesale index and the cost of living index did not move in parity with each other. In fact if they had moved exactly parallel to each other, the disparity curve would have been the horizontal line through 100. It will also be seen that it was only during 1927-28 and 1928-29 the disparity curve almost coincided with this 100 line.

Movements of Calcutta wholesale index number and of the Bombay cost of living index number are also shown in Tables 1 and 2. It will appear from these tables that the Bombay cost of living index was fairly steady during the three years 1926-27, 1927-28 and 1928-29, the annual averages respectively being 155, 152 and 147. It began to show a downward tendency from September, 1927, along with the fall in wholesale prices. The disparity between the two indices was the widest in July, 1926, since when it began to narrow down, minima having been attained in March, July and November, 1928. From that time it began to widen again and the disparity became considerable by the close of the year 1929. The reason is that the cost of living index remained practically steady up to the end of 1929 but the wholesale price index began to fall definitely from April, 1929. During that month, Calcutta wholesale index recorded a fall of 6 points as compared with the price level for the same month in 1928 and the fall became almost continuous from October, 1929.

Disparity between the two.

In order to show better the divergence between the Calcutta wholesale price index and the Bombay cost of living index, the former has been divided by the latter and the quotient multiplied by 100, the result being shown in Table 3.

TABLE I.
INDEX NO. OF WHOLESALE PRICES IN CALCUTTA. PRICES IN JULY, 1914=100.
(Data from the Indian Trade Journal).

	April.	May.	June.	July.	August.	September.	October.	November.	December.	January.	February.	March.	Annual.
1919-20	188	195	197	212	203	198	203	207	212	216	207	197	202
20-21	198	207	204	207	206	206	204	192	178	177	172	173	195
21-22	181	181	176	181	182	185	182	177	178	175	177	181	180
22-23	180	183	179	176	172	171	172	174	172	175	176	177	176
23-24	173	172	170	165	167	169	169	172	174	169	172	174	171
24-25	169	171	171	174	175	174	176	175	171	165	164	162	171
25-26	167	159	153	156	154	154	157	162	158	159	154	151	157
26-27	149	146	147	143	145	146	144	147	146	145	148	146	146
27-28	145	146	148	149	151	149	147	148	148	145	144	144	147
28-29	146	145	144	146	143	142	143	146	145	145	144	143	145
29-30	140	139	138	142	143	143	140	137	134	131	126	125	137
30-31	123	121	116	115	114	111	107	103	100	98	99	100	109
31-32	98	97	93	93	92	91	96	97	98	97	97	94	95
32-33	92	89	86	87	91	91	91	90	88	88	86	82	88
33-34	84	87	89	91	89	88	88	88	89	90	89	88	88
34-35	89	90	90	89	89	89	89	88	88	94	90	87	90
35-36	88	91	91	91	89	89	93	92	93	92	91	91	91

TABLE 2.
INDEX No. OF COST OF LIVING (BOMBAY) BASE: JULY, 1914=100.
(Data from Bombay Labour Gazette.)

	April.	May.	June.	July.	August.	September.	October.	November.	December.	January.	February.	March.	Annual.
1919-20	167	168	174	186	179	172	174	173	174	183	181	177	176
20-21	172	173	181	190	191	192	193	186	181	169	162	160	179
21-22	160	167	173	177	180	185	183	182	179	173	165	165	174
22-23	162	163	163	165	164	165	162	160	161	156	155	154	161
23-24	156	153	152	153	154	154	152	153	157	159	156	154	154
24-25	150	150	153	157	161	161	161	161	160	157	157	159	157
25-26	158	156	154	157	152	151	153	153	155	155	154	155	154
26-27	153	153	155	157	155	155	155	154	156	156	155	155	155
27-28	153	152	154	156	157	154	151	150	151	154	148	145	152
28-29	144	147	146	147	146	145	146	147	148	149	148	149	147
29-30	148	147	147	148	149	149	149	150	150	147	144	141	147
30-31	140	139	140	139	136	136	131	127	121	117	113	111	129
31-32	111	110	107	108	108	108	108	108	109	110	110	111	109
32-33	108	107	107	109	109	109	109	110	110	109	106	106	108
33-34	101	100	104	103	103	102	100	101	98	96	96	94	100
34-35	93	94	95	97	97	100	100	101	99	98	99	98	98
35-36	98	100	101	101	103	103	103	104	105	103	102	102	102

TABLE 3.

DISPARITY BETWEEN WHOLESALE PRICE AND COST OF LIVING INDICES.

Method of Calculation: $\frac{\text{Calcutta Wholesale Price Index}}{\text{Bombay Cost of Living Index}} \times 100.$

	April.	May.	June.	July.	August.	September.	October.	November.	December.	January.	February.	March.	Annual.
1919-20	112.6	116.1	113.2	114.0	113.4	115.1	116.7	119.6	121.8	118.0	114.4	111.3	114.8
20-21	115.1	119.6	112.7	108.9	107.9	107.3	105.7	103.2	98.3	104.7	106.2	108.1	108.9
21-22	113.1	108.4	101.7	102.3	101.1	100.0	99.4	97.3	99.4	101.2	107.3	109.7	103.4
22-23	111.1	112.2	109.8	106.7	104.9	103.6	106.2	108.8	106.8	112.2	113.6	114.9	109.3
23-24	110.9	112.4	111.8	107.8	108.4	109.7	111.2	112.4	110.8	106.3	110.3	113.0	111.0
24-25	112.7	114.0	111.8	110.8	108.7	108.1	109.3	108.7	106.9	105.1	104.5	101.9	108.9
25-26	105.7	101.9	99.4	99.6	101.3	102.0	102.6	105.9	101.9	102.6	100.0	97.4	102.0
26-27	97.4	95.4	94.8	91.1	93.6	94.2	92.9	95.5	93.6	92.9	95.5	94.2	94.2
27-28	94.8	96.1	96.1	95.5	96.2	96.8	97.4	98.7	98.0	94.2	97.3	99.3	96.7
28-29	101.4	98.6	98.6	99.3	97.9	97.9	97.9	99.3	98.0	97.3	97.3	96.0	98.6
29-30	94.6	94.6	93.9	96.0	96.0	96.0	94.0	91.3	89.3	89.1	87.5	88.7	93.2
30-31	87.9	87.0	82.9	82.7	83.8	81.6	81.7	81.1	82.6	83.8	87.6	90.1	84.5
31-32	88.3	88.2	86.9	86.1	85.2	84.3	88.9	89.8	89.9	88.2	88.2	84.7	87.2
32-33	85.2	83.2	80.4	79.8	83.5	83.5	83.5	81.8	80.0	80.7	81.1	77.4	81.5
33-34	82.4	87.0	85.6	88.4	86.4	86.3	88.9	87.1	90.8	93.8	93.7	93.6	88.0
34-35	95.7	95.8	94.8	91.6	91.8	89.0	89.0	87.1	88.9	95.9	90.9	88.7	91.8
35-36	89.8	91.0	90.1	90.1	86.4	86.4	90.3	88.5	88.6	89.3	89.2	89.2	89.2

This table shows the percentage rise or fall of the wholesale index above or below the cost of living index for the past few years. If we consider the quinquennium 1924-25 to 1928-29, it will be apparent that the disparity was the least in 1925-26 and in 1928-29 and that it was less in 1927-28 than in 1926-27, the year in which our currency was stabilised. The average disparity indices for these five years were 108·9, 102·0, 94·2, 96·7 and 98·6 respectively. But the year 1925-26 cannot be taken as the period of stability because the amplitude of fluctuations that year was wider than in 1927-28 and 1928-29 as shown below:—

Fiscal Year	Bombay Cost of Living Index.		
	Highest Value	Lowest Value	Difference
1925-26	105·7	97·4	8·4
1927-28	99·3	94·8	4·5
1928-29	101·4	96·0	5·4

Although the movement of the cost of living index in relation to the wholesale price index has been described in much detail, it should be recalled that the cost of living does not measure the cost of production. It has therefore been thought necessary to test the correspondence in an indirect manner through a study of the possible effects of disparity between the two.

Movement of prices *inter se*.

For instance if there is a violent upward and downward oscillation of prices *inter se*, we should suspect economic disequilibrium, even though the general price level remains fairly steady. Let us therefore see how the prices of different groups of commodities behaved during the period of our enquiry. Two broad groups of commodities are (a) foodstuffs and raw materials and (b) manufactured goods. These behave differently during different phases of the trade cycle—strain, crisis, depression, revival and prosperity. Agriculture all the world over, is less organised and hence less able to adjust its production to demand than manufacture. In other words, the supply of agricultural goods is less flexible. The demand for agricultural goods is also generally inelastic. These peculiarities are broadly true in the case of raw materials as well, which explains why foodstuffs and raw materials fall much more in price at the beginning of a depression. For the same reasons they are also the first to rise in price when a trade revival sets in. If therefore the movement of prices of both raw materials and finished goods is substantially similar during any period, it may be reasonably inferred that the period is one of comparative economic stability.

Unfortunately the index number of prices of these two groups are not available in Government of India publications. Fairly reliable index numbers of export and import prices in India may however be obtained from the *Review of Trade of India*. As the bulk of our imports consists of manufactured goods and by far the largest proportion of our exports

comprise agricultural goods and raw materials, these two index numbers may be regarded as reasonably valid substitutes for the index numbers of the above two groups of commodities. It is true that some of our manufactures and raw materials may not at present appear in international trade. Prices of such domestic goods may be different in our country from those of internationally traded goods whose prices in one country do not differ from those in another by more than the cost of transport *plus* the monetary equivalent of any impediment to trade, *e.g.*, tariff. But there is no generic difference between domestic goods and international goods and the distinction between them should not be too rigidly drawn.

It appears from Table 4 that both import and export price indices fell in 1925-26, the former by 22 points and the latter by 2 points, as compared with the respective indices in 1924-25. In 1926-27, the export index fell by 20 points and the import index by 10 points as compared with the indices of the previous year. During the next financial year, the oscillations of the two indices were different, export index fell by only 2 points while import index by as much as 12 points. Thus though the movements of the two indices were by no means uniform the average export and import prices during the two years 1927-28 and 1928-29 were fairly steady; import index in 1928-29 recorded a fall of 3 points as compared with 1927-28. A similar fall is recorded in the export index also. This lends support to the contention that the years 1927-28 and 1928-29 were of comparative stability.

TABLE 4.

EXPORT AND IMPORT PRICES IN INDIA.

(1913-14=100.)

(Data from the Review of Trade of India).

Year.	Price Level of Exports.	Price Level of Imports.
1913-14	100	100
19-20	158	206
20-21	140	237
21-22	127	214
22-23	140	169
23-24	145	190
24-25	154	180
25-26	152	158
26-27	132	148
27-28	130	136
28-29	127	133
29-30	118	128
30-31	94	105
31-32	78	88
32-33	75	82
33-34	70	79
34-35	70	77

Any disparity between prices and costs will also be revealed by inflated or reduced profits, which must result in company promotions and liquidations. An attempt was made to study this incidence of disparity between costs and prices, but it proved abortive. In the first place, insolvent companies are not quickly dissolved; they sometimes drag on for five or six years before the Registrar of Joint Stock Companies is able to remove them from the register. As regards incorporations also there are two difficulties. There may be started some companies which have been reconstructed out of defunct companies. Secondly, only authorised capital may be shown in the return, although it is notorious to what extent the authorised capital differs from subscribed,—not to speak of paid-up capital.

Stability of profit.

In these circumstances, it has been thought advisable to scrutinise the evidence of disparity in an indirect manner. If the gap between prices and costs becomes wider, there is a greater profit, attracting more and more long-term capital to industries and leaving less and less long-term funds for investment in Government securities. It follows therefore that other things remaining the same, the steadiness of $3\frac{1}{2}$ per cent. Government paper means steadiness in profits, in employment and in economic activity generally. The following table (No. 5) and Chart II will show the situation.

TABLE 5.

INDEX NUMBER OF THE PRICE OF $3\frac{1}{4}$ PER CENT. GOVERNMENT PAPER. BASE: JULY, 1914=100.

[Data prior to April, 1933, from the Indian Trade Journal and after March, 1933,
from the Monthly Survey of Business Conditions in India.]

Year.	April.	May.	June.	July.	August.	September.	October.	November.	December.	January.	February.	March.	Annual.
1919-20	74	74	73	72	71	71	71	69	67	65	64	62	72
20-21	62	61	61	*	*	*	59	54	55	61	58	56	58
21-22	*	*	*	62	63	62	62	62	62	58	58	58	61
22-23	58	61	60	60	59	60	60	60	60	60	60	62	60
23-24	65	67	67	67	68	68	67	65	65	67	69	69	67
24-25	70	70	71	70	70	70	67	69	69	70	69	70	69
25-26	70	71	72	72	72	72	71	71	71	73	74	76	71
26-27	79	81	81	81	81	81	81	81	82	81	81	82	80
27-28	82	82	81	81	80	79	79	79	78	79	79	79	81
28-29	79	79	79	79	77	77	76	76	76	76	76	75	78
29-30	75	75	73	71	71	72	71	71	70	69	67	69	72
30-31	71	67	68	67	66	67	67	68	67	65	65	65	68
31-32	65	65	63	63	61	58	54	57	54	55	58	64	63
32-33	64	65	65	72	72	72	76	77	76	81	85	88	70
33-34	91	88	84	87	89	88	86	86	86	87	88	92	87
34-35	92	92	92	93	93	95	95	97	101	102	101	99	94
35-36	95	98	98	99	96	93	94	99	100	100	101	102	98

* Indian Trade Journals for these months are not available.

** Averages of the available monthly figures.

CHART II.

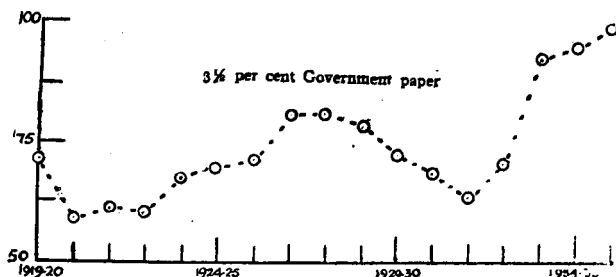
INDEX NUMBER OF THE PRICE OF $3\frac{1}{2}$ PER CENT. GOVERNMENT PAPER.

Chart II for the price of $3\frac{1}{2}$ per cent. Government paper is much more irregular than the previous chart. One reason is that it is drawn on the arithmetic scale whereas the other one has been drawn on the logarithmic scale. But there are other reasons for such violent movement. As pointed out above, economic stability has to be presumed from stability in the price of Government securities, only if other conditions remain the same. For instance, if the credit of Government is impaired owing to, say, accumulation of deficits in the budget, the price of Government securities must go down whether there is a slackened demand for industrial investments or not. This is well illustrated in the case of the $3\frac{1}{2}$ per cent. Government paper. During the post-war boom, there was no improvement in the price, the average for the year 1919 being 78, the same as that for 1918, compared with 99 for 1914. The succession of budget deficits to which reference will be made in a subsequent lecture brought the price of the $3\frac{1}{2}$ per cent. Government paper below 60 on several occasions during 1921 and 1922. It was only from 1923 that an upward trend is noticeable. A fairly steady condition prevailed during 1926-27, 1927-28 and 1928-29.

From the above analysis it is apparent that although the two charts do not individually prove stable conditions during 1927-28 and 1928-29, yet their cumulative effect is to show that these two years were subject to less violent movement than other years shown on the charts. In the next lecture, some other data will be furnished which point to the same conclusion.

LECTURE III.

PERIODS OF ADJUSTMENT AND OF COMPARATIVE STABILITY (1926-29) :

EXTERNAL EVIDENCE.

In the last lecture it was pointed out that there was a substantial adjustment between cost and prices in India during 1927-28 and 1928-29. Let us now consider whether there was also external economic equilibrium during the period in question. In the present as in the previous lecture, we desire to emphasise only the statistical aspect, leaving general considerations for the next lecture both for external as well as internal economic equilibrium.

The three conditions of external equilibrium mentioned in the second lecture are:—

- (1) maintenance of gold movement on the same scale throughout the period;
- (2) parity between short-term rates at home and abroad;
- (3) parity between the price levels at home and abroad of internationally traded goods.

Gold movement.

The last condition has been examined by the Hilton Young Commission and also by us in the last lecture. As regards gold movements, the necessary data have been compiled from the annual reports of the Controller of Currency in Table 6 and illustrated in Chart No. III. It will be apparent that during the years 1927-28 and 1928-29, gold imports were practically on the same scale as the pre-war average which again did not differ materially from the average for the decade 1919-20 to 1928-29.

Chart No. III is otherwise interesting. It will be seen that the whole aspect of the situation was altered after 1930-31,—to be more exact, after the suspension of the gold standard in England. The sequences of events will be discussed in greater detail in Lecture VIII and the causes and consequence will also be described there. For our present purpose, it is enough to notice that instead of heavy imports we then had considerable exports. The small exports during 1920-21 and 1921-22 pale into insignificance when compared with the exports after 1930-31, still more so when comparison is made, as it should be, with our normal pre-war or post-war imports.

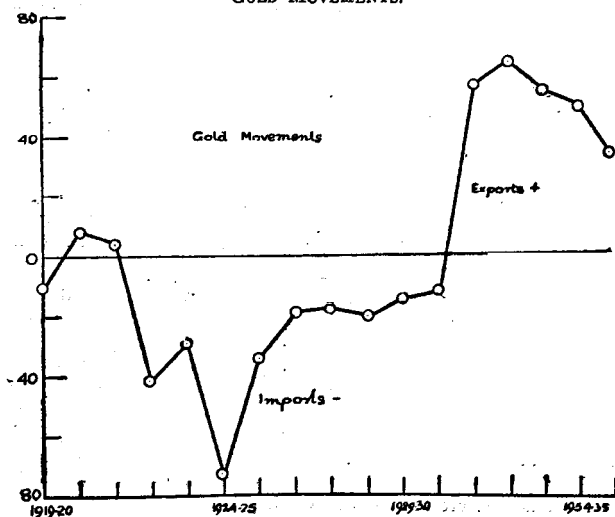
TABLE 6.

GOLD MOVEMENTS (PRIVATE GOLD)

+ INDICATES EXPORTS FROM AND - IMPORTS INTO BRITISH INDIA.

[Data from Report of Controller of the Currency (in India).]

Year.	Value (in lakhs of rupees.)	Quantity (in lakhs of ounces).
Average of 10 pre-war years ending 1913-14.	-2087	
Average of 10 years ending 1928-29.	-2372	
1919-20	-1097	
20-21	+ 888	
21-22	+ 279	
22-23	-4118	
23-24	-2919	
24-25	-7393	
25-26	-3485	-61.4
26-27	-1940	-33.9
27-28	-1810	-31.8
28-29	-2120	-37.9
29-30	-1422	-25.2
30-31	-1275	-22.4
31-32	+5797	+76.3
32-33	+6552	+83.5
33-34	+5705	+67.0
34-35	+5254	+56.9
35-36	+3736(a)	+40.2(b)

CHART III.
GOLD MOVEMENTS.(a) Taken from the *Review of Trade of India, 1935-36.*(b) Taken from the *Annual Statement of the Seaborne Trade of British India* for the year ending 31st March, 1936, Vol. I.

Parity in interest rates at home and abroad.

For studying the second condition of equilibrium, it has been thought advisable to compare the bank rate in India with that in the U.S.A., for both are large agricultural countries, with decentralised banking systems and rapidly growing manufactures. It will be evident from Table 7 and Chart No. IV that the Indian rate was in greater adjustment with the American rate during the two years under consideration than at any period of two years before or after. For it must be remembered that on account of different risks and different taxes in the two countries, the rates cannot be exactly equal. All that is necessary is that the two should show the same trend.

In order to show whether the Indian bank rate was moving in parity with the American bank rate, it has been thought advisable to draw at the bottom of the chart the difference between the two rates. It will be seen that during 1927 and 1928, it remained practically horizontal, showing substantial adjustment in the two rates during that period.

TABLE 7.

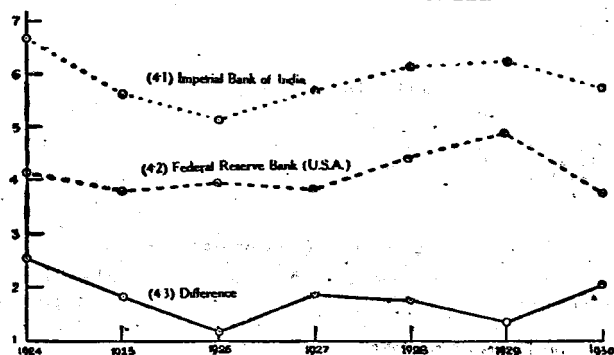
BANK RATE IN INDIA AND THE U. S. A.

[Data from Statistical Year Book of the League of Nations (1930-31).]

Year.	Imperial Bank of India.	U.S.A. Fed. Reserve Banks.	Difference.
1924	6.68	4.14	2.54
1925	5.64	3.81	1.83
1926	5.17	3.99	1.18
1927	5.73	3.85	1.88
1928	6.20	4.42	1.78
1929	6.33	4.94	1.39
1930	5.89	3.82	2.07

CHART IV.

BANK RATE IN INDIA AND THE U. S. A.



Another indication of external equilibrium is the adjustment of long-term rates of interest in India and abroad. That it was not attained in 1926-27, is clear from the following extract from the Budget Speech of the late Sir Basil Blackett on the 28th of February, 1927—"during the year 1926-27 (there) has undoubtedly been the movement of capital from India to London due to the higher rates for both long-term and short-term money which have prevailed in London for the greater part of the financial year." By the end of February, 1928, as Sir Basil observed in his Budget Speech for 1928-29, the disparity between the prices of $3\frac{1}{2}$ per cent. rupees stock in India and India $3\frac{1}{2}$ per cent. sterling stock, became much less than it was a year ago and this unusual movement of funds from a debtor to a creditor country slackened, indicating a return to more normal condition. Sir Basil hailed this transfer of funds from India to London "as the first step towards India's becoming a creditor nation". As a matter of fact, it only indicates our external disequilibrium which must have been partly due to the speculative transfer of funds to London, in order to take advantage of the possible stabilisation of the rupee at 1s. 4d. in March, 1927. This is another additional reason why the year 1926-27 cannot be taken as a period of stability. The disparity between the long-term rates of interest in India and England may be judged from the following table compiled from figures given in our Budget Statements for 1927-28 and 1928-29.

Market Price on—

	1st Feb. 1923.	30th April 1923.	1st Feb. 1924.	1st Feb. 1925.	1st Feb. 1926.
	Rs. as.	Rs. as.	Rs. as.	Rs. as.	Rs. as.
$3\frac{1}{2}$ % Government of India rupee loan.	57 0	(a)	66 0	66 9	70 8
$3\frac{1}{2}$ % India loan in sterling.	(a)	70 4	(a)	(a)	68 0

	31st Dec. 1926.	1st Feb. 1927.	31st Dec. 1927.	1st Feb. 1928.
	Rs. as.	Rs. as.	Rs. as.	Rs. as.
$3\frac{1}{2}$ % Government of India rupee loan.	(a)	77 7	(a)	75 15
$3\frac{1}{2}$ % India loan in sterling.	71 4	70 6	72 12	(a)

Changes in terms of trade.

Let us now go into some of the deeper signs of external equilibrium. In the first place, a shift in the barter terms of trade, whether gross or

(a) Figures not obtainable.

net,¹ reflects external disequilibrium to some extent. Changes in these terms, as pointed out by Whale, may arise in any or all of the following cases:—

- (a) changes in demand conditions;
- (b) changes in supply conditions;
- (c) import duties, export duties and export bounties;
- (d) changes in transport costs;
- (e) changes in the volume of one-sided payments.

It will be readily seen that there was no great change in any of these factors during 1927-28 and 1928-29. It is true that both demand and supply factors were modified considerably during war and post-war periods, but conditions had settled down by 1927. Similarly, whatever might have been done earlier or later on, there was no violent disturbance in the tariff level during the two years under consideration and there was no bounty. Nor was there any great change in shipping freight as shown by the Economist index number quoted in Table 8, provided that allowance is made for the short and sharp rise in rates due to the General Strike in England. The table is otherwise interesting. It shows the heavy decline in shipping freight due to the depression and its slow rise during the period of recovery.

¹ "Gross barter terms of trade apply to the relation between the physical volume of a country's total exports and the physical volume of her total imports; net barter terms of trade apply only to the relation between the physical volume of goods imported and the physical volume of goods exported in payment for the imports. If merchandise imports and merchandise exports are the only items in the international accounts, the net and the gross barter terms of trade will be the same. If, however, other items such as capital exports or indemnity payments appear in the accounts, not all the goods sent are in payment for goods received; some of the goods are sent without any receipt of goods in exchange. In such case, the gross and net barter terms of trade will differ." (*White's French International Accounts*, p. 225.)

TABLE 8.

SHIPPING FREIGHT INDEX NUMBER (1898-1913=100) INDEX IS COMPOSED OF
(1) SOUTH WALES—BOMBAY, (2) SOUTH WALES—COLOMBO, AND (3) BOMBAY—U.K. (CONTINENT).

[Data from the Economist (London).]

Year April to March.	April.	May.	June.	July.	August.	September.	October.	November.	December.	January.	February.	March.	Annual.
1923-24	133.8	127.0	125.5	122.4	117.7	117.8	119.4	122.7	124.4	124.9	129.3	132.1	124.7
24-25	127.4	127.7	129.5	120.1	119.0	124.9	126.6	120.5	119.8	123.8	122.0	117.0	123.2
25-26	116.0	108.4	105.5	106.2	112.2	113.4	106.5	109.9	110.1	119.6	118.5	114.6	111.7
26-27	109.2	107.9	120.4	119.8	119.6	121.7	141.7	158.0	132.9	122.7	130.4	132.1	126.4
27-28	124.4	130.9	117.6	115.8	121.4	119.3	116.4	117.6	114.2	113.6	112.4	106.7	117.5
28-29	105.9	110.1	104.0	99.4	108.4	109.0	116.9	117.8	126.8	123.7	117.9	112.2	112.7
29-30	106.3	109.0	104.0	106.3	117.0	115.3	117.4	110.7	109.0	99.8	93.4	94.2	106.9
30-31	94.8	94.2	95.7	102.8	104.5	103.7	101.3	99.8	103.8	101.3	96.9	99.2	99.8
31-32	94.0	94.8	91.8	87.6	88.4	86.1	97.6	95.1	98.1	90.9	87.4	87.7	92.0
32-33	90.8	93.5	93.1	90.8	90.7	92.6	94.5	94.7	96.0	94.5	90.7	87.9	92.5
33-34	85.9	84.2	86.5	90.5	90.9	92.7	92.4	92.7	93.6	92.4	93.6	91.4	90.5
34-35	90.1	89.8	88.0	88.3	96.1	98.6	96.3	94.5	96.0	94.3	94.5	92.3	93.2
35-36	90.8	88.6	86.5	83.4	83.3	88.8	110.0	109.7	107.1	99.2	99.7	97.0	95.4

Balance of payments.

As regards balance of payments, figures are necessarily rough all the world over. In the case of India they are largely conjectural. As pointed out in the *Report of the Controller of Currency* for 1929-30 (pp. 6-7), the items which are perfectly dependable are those relating to Government remittances and to transfer of Government securities between London and Indian registers. As regards trade figures, the value of exports is fairly reliable, for they are mostly staple agricultural products. The same cannot be said of imports, some of which may be undervalued because of the duties. Other items also lend themselves to risks of error the possibility of which cannot be ignored.

The following Table (No. 9) is extracted from the *Balances of Payments*, 1935, issued by the League of Nations, for what it is worth. It may be noted that in spite of the large change in long-term capital in 1927-28 and 1928-29, the movement of known items of total capital during those two years was comparatively small.

TABLE 9.
INDIA'S BALANCE OF PAYMENTS (IN MILLIONS OF RUPEES). + INDICATES BALANCE
IN FAVOUR OF AND—BALANCE AGAINST INDIA.

[Data from Balance of Payments, 1935, League of Nations.]

Year.	Goods, services and gold.					Known capital items.			All items.
April to March.	Merchandise.	Interest and Dividends.	Other services.	Gold.	Total.	Long-term	Short-term.	Total.	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1923-24	+ 1105.3	- 323.7	- 433.0	- 292.1	+ 56.5	+ 221.0	- 10.5	+ 210.5	+ 267.0
24-25	+ 1176.6	- 317.8	- 333.7	- 738.8	- 213.7	- 122.5	- 0.3	- 122.8	- 336.5
25-26	+ 1190.5	- 289.9	- 364.8	- 348.6	+ 187.2	- 165.3	+ 3.3	- 162.0	+ 25.2
26-27	+ 351.0	- 297.8	- 347.2	- 194.0	- 488.0	+ 383.8	- 0.5	+ 383.3	- 104.7
27-28	+ 513.4	- 314.4	- 347.0	- 181.0	- 329.0	+ 146.8	- 65.5	+ 81.3	- 247.7
28-29	+ 665.0	- 324.7	- 312.2	- 212.0	- 183.9	+ 5.2	+ 7.1	+ 12.3	- 171.6
29-30	+ 538.1	- 316.0	- 180.1	- 142.2	- 100.2	+ 133.2	+ 41.2	+ 174.4	+ 74.2
30-31	+ 371.3	- 335.8	- 159.1	- 127.6	- 251.2	+ 432.2	- 53.3	+ 378.9	+ 127.7
31-32	+ 222.6	- 347.6	- 179.4	+ 579.7	+ 275.3	+ 117.6	- 86.8	+ 30.8	+ 306.1
32-33	- 54.7	- 344.1	- 161.6	+ 655.2	+ 94.8	- 65.0	- 81.5	- 146.5	- 51.7
33-34	+ 270.9	- 339.2	- 121.9	+ 570.5	+ 380.3	- 215.5	- 96.2	- 311.7	+ 68.6
34-35	+ 112.6	- 325.1	- 139.4	+ 525.4	+ 173.5	- 86.7	- 105.6	- 192.3	- 18.8
35-36	+ 193.8	- 320.2	- 159.7	+ 373.6	+ 87.5	..	..	- 121.1	- 33.6

Gross and net barter terms.

The figures for the gross and net barter terms, as given in Table 10, have been calculated on the basis of the data published in the annual *Review of the Trade of India*. Taussig's method has been substantially followed, with this difference that whereas Taussig calculates net

barter term as $\frac{\text{Import price index}}{\text{Export price index}}$ we have taken its reciprocal for

the purpose. This has been done for two reasons. Firstly because, it has been adopted, not only by English writers but also in the League of Nations publications such as the annual *Review of World Trade* and secondly because it is more convenient to indicate a fall in the index as an unfavourable movement of the term of trade and *vice versa*. But according to Taussig's calculation, if the barter term of trade in any year is less than unity, it means a favourable movement in the term. With regard to gross barter term also, we have taken the reciprocal of Taussig's figures. In Table 10, the quantum indices of Indian exports and imports on the basis of 1913-14 as 100, have been estimated from the money value of our exports and imports for different years at 1913-14 prices. The gross barter term has been obtained by dividing the quantum of imports by the quantum of exports and by multiplying the quotient by 100.

It has been pointed out in the *Review of World Trade*, 1934 (League of Nations), p. 75, that both "price and quantum indices are likely to be misleading if comparison is made over long periods of time". To meet this objection, Table 10 has been divided into two sections, Section A giving price and quantum indices from 1913-14 to 1934-35 and Section B giving the same figures from 1927-28 with that year as the base period.

It will be seen that the gross and net barter terms of trade are nearly the same during 1927-28 and 1928-29, verifying the fact already mentioned, *vis.*, that there was no abnormal capital movement during the period of review.

A similar verification of the fact that there was no violent change in demand and supply conditions is available. For it stands to reason that if there is no change in relative economic conditions, there should be no change in quanta of trade. Relevant figures are given in Table No. 10 and shown graphically in Charts V and VI.

It is interesting to note in this connection that the quantum of export and import trade practically reached the level of 1913-14 during the year 1927-28. It may also be noted that both gross and net barter terms of trade of India in 1927-28 and 1928-29 were nearer to the 1913-14 level than in any other post-war year. It is true that in 1925-26 our net barter term of trade was closer to the 1913-14 level, but the gross barter term that year was farther away.

TABLE 10.
GROSS AND NET BARTER TERMS OF TRADE.
SECTION A. (1913-14=100).
[Data from Annual Review of Trade of India.]

Year April to March.	Value at 1913-14 prices of		Quantum of		Gross Barter term of trade [(5) ÷ (4) × 100].	Index No. of Prices of		Net Barter Term of Trade [(7) ÷ (8) × 100].
	Exports (Rs. Crores).	Imports (Rs. Crores).	Exports. (Figures in (2) on the basis of 1913-14=100.)	Imports. (Figures in (3) on the basis of 1913-14=100.)		Exports 1913-14=100	Imports 1913-14=100	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1913-14	244	183	100	100	100	100	100	100
19-20	198	101	81.1	55.2	68.1	158	206	76.7
20-21	172	142	70.5	77.6	110.0	140	237	59.1
21-22	182	124	74.6	67.8	90.9	127	214	59.3
22-23	214	138	87.7	75.4	86.0	140	169	82.8
23-24	240	120	98.4	65.6	66.7	145	190	76.3
24-25	250	137	102.5	74.9	73.1	154	180	85.6
25-26	246	143	100.8	78.1	77.5	152	158	96.2
26-27	228	156	93.4	85.2	91.2	132	148	89.2
27-28	248	181	101.6	98.9	97.3	130	136	95.6
28-29	260	190	106.6	103.8	97.4	127	133	95.5
29-30	263	189	107.8	103.3	95.8	118	128	92.2
30-31	235	157	96.3	85.8	89.1	94	105	89.5
31-32	200	143	82.0	78.1	95.2	78	88	88.6
32-33	176	162	72.1	88.5	122.7	75	82	91.5
33-34	209	146	85.7	79.8	93.1	70	79	88.6
34-35	216	172	88.5	94.0	106.2	70	77	90.9
35-36 *								

* Data for 1935-36 with 1913-14 as base year, are not available.

SECTION B (1927-28=100).

[Data from the Review of Trade of India in 1935-36.]

Year April to March.	Value at 1927-28 prices of		Quantum of		Gross Barter term of trade [(5) ÷ (4) × 100].	Index No. of Prices of		Net-Barter Term of Trade [(7) ÷ (8) × 100].
	Exports (Rs. Crores).	Imports (Rs. Crores).	Exports. (Figures in (2) on the basis of 1927-28=100.)	Imports. (Figures in (3) on the basis of 1927-28=100.)		Exports (1927-28= 100).	Imports (1927-28= 100).	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1927-28	319	250	100	100	100	100	100	100
28-29	339	263	106	105	99.1	97.5	96.4	101.1
29-30	345	258	108	103	95.4	90.2	93.2	96.8
30-31	308	206	97	83	85.6	71.5	80.0	89.4
31-32	263	176	83	71	85.5	59.2	71.7	82.6
32-33	239	203	75	81	108.0	55.3	65.2	84.8
33-34	275	182	86	73	84.9	53.5	63.5	84.3
34-35	280	210	88	84	95.5	54.1	63.0	85.9
35-36	282	216	88	87	98.9	56.9	62.1	91.6

III

PERIODS OF ADJUSTMENT AND STABILITY

39

CHART V.

EXPORT AND IMPORT QUANTA; GROSS AND NET BARTER TERMS, 1913-14:
100.

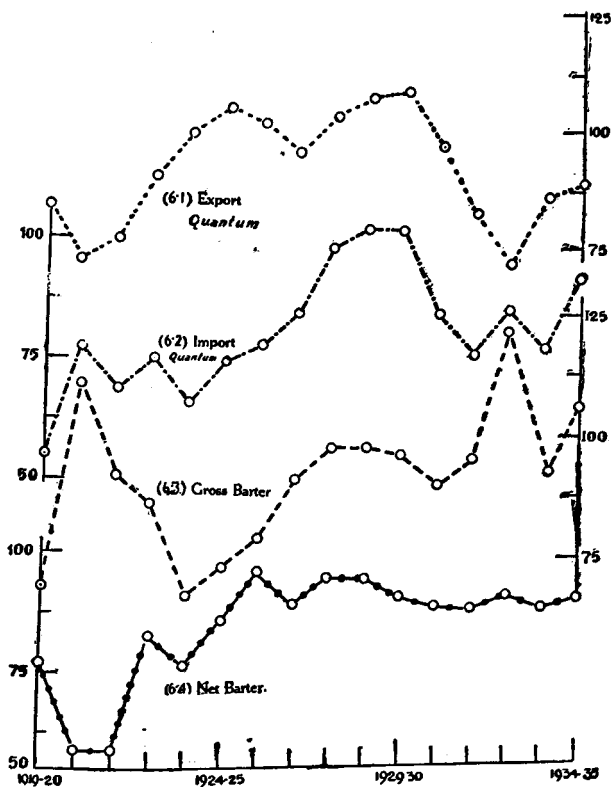
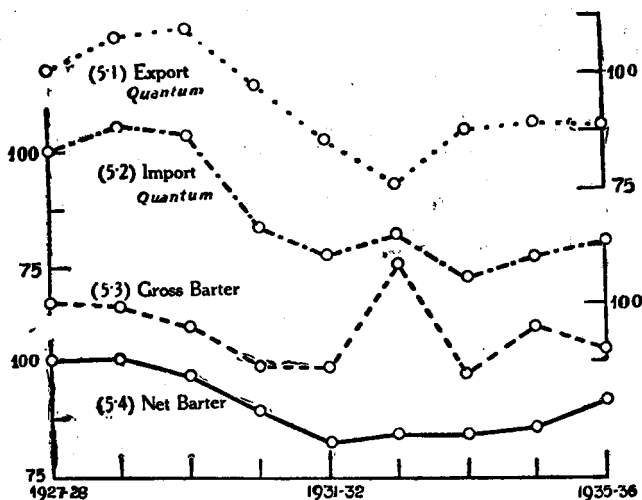


CHART VI.

EXPORT AND IMPORT QUANTA; GROSS AND NET BARTER TERMS 1927-28:
100.

These Charts (No. V and No. VI) are otherwise interesting. It will be seen that the gross and net barter terms of trade exhibit similar trends from 1927-28 to 1930-31, both rising and falling together although not exactly to the same extent. Since then there is lack of parity between the two. From 1930-31 to 1931-32, the net term as given in Section A of Table 10, fell by 0.9 but the gross term rose by as much as 6.1. During the year following, the former rose by 2.9 and the latter only by 27.5. The figures for the subsequent years show an equally erratic movement. The gross barter term was affected by the considerable gold outflow, for it not only met our foreign obligations but also paid for a substantial part of imports. It is no wonder therefore that our imports rose proportionately higher than exports, recording an increase in gross barter term.

Even the net barter term figures are not free from irregularities, but not to same extent. It should be remembered that in calculating the net barter term declared values of exports and imports were utilised and the effect of customs duties, which were heavy and variable, was eliminated to some extent.

The disparity between the quanta of exports and imports is equally noticeable. From 1921-22, the gap between the two continued to widen and began to narrow down only after 1926-27. There was again a fairly wide disparity after 1931-32. The lack of balance in the quanta of exports and imports and in the gross and net barter terms point to disturbances in economic conditions, which will be more fully dealt with in the concluding lectures.

It is readily conceded that all the above tables and diagrams do not give any irrefutable proof that the fiscal years 1927-28 and 1928-29 were of comparative stability. But there can be no gainsaying the fact that the data which are more dependable lead to that conclusion. In any case, there is no doubt whatsoever that the statistics presented from different fields of economic activity clearly show that adjustment was more complete during those two years than at any time before or after, whether economic stability as enunciated by economic theory, was attained or not.

LECTURE IV.

PERIODS OF ADJUSTMENT AND OF COMPARATIVE STABILITY (1926-29) : EXTERNAL FACTORS.

In the last two lectures, statistical evidence was given to prove that during the year 1926-27 adjustment was still going on, the following two years being a period of comparative stability, both internally and externally. If that is so, an examination of the causes leading to such stability and the results following from it should give valuable lessons to theoretical economists as well as to currency authorities.

Let us first consider as to how this was attained,—how far this was due to (a) monetary and (b) non-monetary causes. It has already been pointed out that India has not yet fully outgrown the stage of barter. Consequently money cannot influence our economic life in the same way as in the West. On the other hand it cannot be safely argued, especially in view of our experience during the last seven years of depression and recovery, that monetary factors do not play their part in our present economic life. To say this does not however mean a denial of the influence of non-monetary factors in bringing about the comparative stability of 1927-29. The fact is that most of these non-monetary factors themselves produced monetary changes; all were influenced considerably by monetary causes. It is therefore hardly necessary to consider the two groups of factors separately. What is proposed is to analyse the effect of external and internal factors, both monetary and non-monetary, on our economic life during the years 1926 to 1928.

Improvement in political relation.

The most important external factor was the improvement in the political relation of France and Germany. The Carthaginian peace wrung from the latter had brought no real peace to Europe. The matter had been made worse by the French occupation of the Ruhr at the beginning of 1923 and the consequent passive resistance organised by Germany. The evacuation of the Ruhr by the French in July 1925, followed by the signing of the Treaty of Locarno a few months later, meant a return of political sanity. The first attempt at the settlement of the Reparation problem under the Dawes Plan which was ratified in August, 1924 also worked in the same direction. The financial and monetary reconstruction of Europe which began towards the close of the depression of 1920-1923, ushered in a period of moderate trade revival as early as 1924. Budgetary equilibrium, an important pre-

requisite of monetary stability was achieved in one country after another. Thus, after six years of budget deficits, the United Kingdom balanced her budget as early as 1920-21. Her example was followed by Austria, Germany and Italy four years later. After a number of years, Holland succeeded in having a surplus budget in 1925, while France and Hungary balanced their budgets in 1926-27. Thus one of the sources of monetary instability due to State borrowing under deficit budgets was removed, and rates of interest tended to come down.¹

Post-war reconstruction.

By 1925, the ravages of the War had been considerably made good. "While her trade lagged behind by some 9 per cent. and her exports were still some 14 per cent. below the pre-war figure, Europe, the real theatre of the War, had by 1925 made substantial recovery and reached the pre-war level of production. In the world as a whole, both the quantum of trade and production in that year were higher than in 1913.² Side by side with this increase in production and trade, the monetary machine was improved by the adoption of the gold standard by a large number of countries. That movement started in 1923 with the restoration of the Austrian currency, followed by the Hungarian in 1924. But the real impetus came when England returned to the gold standard in April 1925, followed by Australia, South Africa and Canada during the same year. Since then the progress became rapid, so much so that by the end of 1926, sixty per cent. of world's population were using money linked to gold.

At the same time it must be remembered that economic stability could not be attained with a mere restoration of the gold standard. Our monetary experience during the last decade has clearly shown that "the restoration of the gold standard at too low a rate of exchange as well as at too high a rate presents grave disadvantages, not only from the national, but also from the international, point of view".³ In theory, the correct rate for the stabilisation of a currency in terms of gold, can be easily discovered. Thus it has been pointed out in a recent authoritative publication which rightly rejects the purchasing power parity theory as a safe guide to action, that the correct rate of exchange is one at which the balance of payments is in equilibrium, and capital movements are kept at a reasonable level.⁴ To translate this abstract proposition into practice is however beset with many difficulties.

¹ But the example of the U.S.A. shows that in spite of budgetary deficits, a country may have cheap money.

² *World Economic Survey* (League of Nations) 1931-32, p. 23.

³ *Draft Annotated Agenda* submitted to the League of Nations by the Preparatory Commission of Experts in 1933, (C. 48 M. 18), p. 13.

⁴ *The Future of Monetary Policy*, p. 134, published by the Royal Institute of International Affairs.

Was it jerry-building?

The main assumptions for a smooth working of the gold standard, *viz.*, (1) that the countries on the gold standard would follow "the rules of game," by allowing movements of monetary gold to have their full and direct effect on the credit structure, (2) that Governments would not interfere with tariffs, quotas and other restrictions and (3) that there exists perfect mobility of the factors of production and there is elasticity in the prices to be paid for the use of these factors in every gold standard country so that any discrepancy between the established rate of exchange and the level of internal costs and prices would be corrected by a flow of gold, did not hold good in their entirety even in the nineteenth century. They were hardly valid in the post-war world.

Adjustment and stabilisation crises.

In the general return to the gold standard which began in 1923, in no case could a rate of exchange be chosen, which permitted both external and internal equilibrium. At this distance of time, it is quite evident that both United Kingdom and Italy rated their national currencies much too high, whereas both France and Belgium put their parity much too low. In the former case there was painful and protracted deflation. In the latter case there was a return of foreign balances but at the same time causing a rise in the domestic price level.

In the words of Prof. Gregory,¹ there was an *adjustment crisis* in the case of those countries where the exchange rate had been fixed too high with reference to the internal level of costs and prices. The intensity of this crisis depended on the rigidity of the cost structure—what Prof. Gregory calls, the inelasticity of the factors of production. In such countries, the prices for exports in terms of world currency meant a smaller return in local currency. Meanwhile all expenses in terms of local currency remained what they were before. It was no wonder that the export trade of such countries languished, imports rose and unemployment was on the increase.

On the other hand, in countries where the exchange rate had been fixed too low as compared with the internal purchasing power of currency, there developed a *stabilisation boom*. In these latter countries, the comparatively low exchange rate checked imports and stimulated exports, unless the latter were retarded by the levy of anti-dumping duties by foreign countries. Such a boom in the export trade led to an increase of employment in the country for the time being. The greater the divergence between the external and internal value of the currency, the greater was the stimulus to employment and the greater the expansion of business activity. But such prosperity was unfortu-

¹ T. E. Gregory—*The First Year of the Gold Standard*, pp. 16-20.

nately short-lived. "The hateful necessity for damping down the rate of expansion" had to be faced and the stabilisation boom ended in a crisis. In either of these two cases there was an element of instability behind the stable exchange rate.

Gap in balance of payments.

One may go further and say that even behind stable wholesale price levels lay hidden great disturbing features. Rapid expansion of credit did not allow the gap in the balance of payment to be revealed in the case of debtor countries, for they could easily borrow at a cheap rate from abroad to bridge that gap. The cheap rate also permitted valorisation schemes, controls and pools for agricultural products which would otherwise have fallen in value in the face of increased production and diminished or stationary consumption.

Other causes of instability.

To a discerning eye, it was not merely a psychological case of pessimism following the optimism of Locarno and large scale return to gold. A deeper analysis tended to show it was not all quiet on the economic front. The following summary of events from the *Report of the Controller of Currency* (1926-27) will bear this out:—

"In Europe the optimism which followed upon the Dawes Reparation scheme and the Locarno Treaty was damped by a serious depreciation in the exchanges of the Latin countries which culminated in July. At the beginning of the year the French franc stood at 141, the Belgian at 128.50 and the Italian lira at 120.85. In July they had fallen to 207, 203 and 149. The Belgian efforts to reconstruct their currency were finally successful in October. . . . The French exchange reached a rough practical stabilisation at the rate of 122-123 to the pound sterling towards the close of the calendar year and the lira appreciated to 102. The endemic disorder in China drew to a head during the year, further debilitating trade in the Far East and adding an unsound element of speculation to an already disturbed silver market. In Japan, the dislocation of the Chinese trade contributed to a set-back which, aggravated by a series of earthquakes, culminated in the collapse of an important firm and a banking crisis just after the close of the year under review. In Great Britain a general strike broke out at the beginning of May. It collapsed almost immediately, but its initial cause, the coal strike, dragged on until the close of the calendar year with serious effects on trade, including that with India. Freight rates had to be increased in October on account of the shortage of coal, another blow to the Indian export trade. In the United States of America . . . the cotton crop yield of more than 18,000,000 bales was the largest in record. As there vival as early as 1924. Budgetary equilibrium, an important pre-

serious effects on India's export trade of the raw material". If we take all these facts into consideration it will appear that the two years 1927-28 and 1928-29 have a far greater claim to be called a period of comparative stability than either the year 1925-26 or 1926-27.

The question now is: What part did monetary management play in bringing about this return to stable conditions? The issue is raised not with the object of condemning management *per se*. Economic progress means economic rigidity. As Sir Henry Strakosch rightly observes, "Progress tends to extend, rather than to diminish, the rigidity of the cost structure. Hence the increasingly urgent need for a monetary system which will obviate violent changes in the level of prices so that major disturbances in the cost-price relations may be avoided".¹ Hence no currency authority in a modern country can allow the monetary machine to work itself automatically. The main points for consideration therefore are the methods and the objectives of currency management leading to the stabilisation of the rupee at the end of March, 1927, which ushered in a period of economic stability.

Price of silver.

As is well known, the Great War profoundly disturbed the economic life of India and her currency system could not escape its influence. From 1900 to 1914, the rupee had remained a note printed on silver with a face value approximately equal to 1s. 4d. in sterling, but as sterling was then linked to gold at the rate of 113 grains of fine gold for £1, the rupee became equal to 1s. 4d. (gold). With the outbreak of the War in 1914, the rupee was once more unmistakably linked to sterling at 1s. 4d. rate which remained in force till 1916. But it became difficult to maintain the rate after that year. From 1900 to 1916, the chief anxiety of the Indian currency authorities was to ensure that the face value of the rupee did not fall below 1s. 3-29/32d. But from 1917 quite a different kind of problem faced the country which was never contemplated by previous currency experts. The problem was that the bullion value of the rupee was rising higher than its face value of 1s. 4d. sterling. As is well known, if the London price of silver is more than 43d. per standard oz., the bullion content of the rupee exceeds 1s. 4d. (sterling) in value. The highest and lowest prices in London of standard silver per ounce annually in 1914 and 1915 and monthly from January, 1916 to March, 1920 are given below in Table No. 11.

¹ Road to Recovery Supplement of the *Economist*, January 5, 1935, p. 8.

TABLE 11.

HIGHEST AND LOWEST PRICES OF STANDARD SILVER IN LONDON.

[Source: *Minutes of Evidence, Babington Smith Committee Vol. II, p. 11*
and *Report of the Controller of the Currency 1919-20.*]

Year.	Month.	Price in Pence.		Year	Month.	Price in Pence.	
		H'ghest.	Lowest.			Highest.	Lowest.
1914		27½	22½	1918	January	45½	43½
1915		27½	22½		February	43½	42½
1916	January	27½	26½		March	46	42½
	February	27½	26½		April	49½	45½
	March	27½	26½		May	49½	48½
	April	35½	29		June	48½	48½
	May	37½	32½		July	48½	48½
	June	32½	30		August	49½	48½
	July	31	28½		September	49½	49½
	August	32	30½		October	49½	49½
	September	32½	32½		November	49½	48½
	October	32½	32½		December	48½	48½
	November	35½	32½	1919	January	48½	48½
	December	37	35½		February	48½	47½
					March	50	47½
1917	January	37½	36		April	49½	48½
	February	38½	37½		May	58	48½
	March	37½	35½		June	54½	53
	April	37½	36½		July	55½	53
	May	38½	37½		August	61½	55½
	June	39½	38		September	64	59
	July	41½	39½		October	66½	62½
	August	46	40½		November	76	65½
	September	55	46		December	79½	73½
	October	48½	41½	1920	January	85	75½
	November	45½	42½		February	89½	82
	December	43½	42½		March	84	65½

It will appear from the Table that the highest price of silver in London in 1914 was only 27 3/4d. but in September, 1917, both the highest and lowest prices were such that the bullion value of the rupee was higher than 1s. 4d. In February, 1920, the price of silver in London reached 89½d. per standard ounce. What was the choice before India in view of this new complication? The late Sir Basil Blackett observed in his Budget Speech for 1923-24, that normally "India's choice was between an attempt to keep the exchange value of the rupee more or less stable and an attempt to keep rupee prices more or less stable".

For a time a vain attempt was made to maintain 1s. 4d. sterling rate and to have a comparatively lower level of prices in India in spite of the rise of prices abroad. In fact 1s. 4d. (sterling) rate would have broken down long before August, 1917, but for the difficulties of freight, restrictions on export, the limitation on the sale of Council Bills and the prohibition of the import of precious metals, all of which tended to check the rise of prices in India in proportion to the rise of prices abroad.

Rise and fall of prices.

But needs of Government finance soon made some rise of prices in India inevitable. For financing the expenses of the Indian army abroad, enlarged issue of currency was necessary. The total circulation of rupees and currency notes increased by some 60 per cent. between 1913 and 1920.¹ The war loans of 1917, 1918 and 1919 became the basis of larger credit by banks. Issues of treasury bills—the so-called “created securities” also operated in the same direction. The total volume of bank deposits in India rose from Rs. 98 crores in 1913 to Rs. 235 crores in 1920. In spite of this, the price level in India did not rise to the same extent as prices abroad. It is no wonder therefore that we had an abnormally favourable balance of trade till 1920.

It is popularly supposed that the favourable balance was due to the fact that there was a keen demand for Indian goods for prosecuting the War on the one hand and that the import of goods from the West was considerably curtailed on the other, due to the shortage and risks of tonnage. The real reason appears however to be the fact that the price level in India was consistently below the price level abroad which acted as a bounty on exports and a check against imports. So long as this disparity between external and internal price levels continued, it was idle to think of economic equilibrium in India. This could be removed either by a rise in the internal price level or by a fall in the price level abroad or by both.

The following table (Table No. 12) and Chart VII illustrate the actual movements of wholesale prices in India and abroad during the period 1920 to 1928.

It will be seen from the table that the fall in the price level during the years 1927 and 1928 below the 1920 level was of the order of 25 per cent. in the case of India, 34 per cent. in the case of Japan, 38 per cent. in the case of the U.S.A. and 54 per cent. in the case of the United Kingdom.

Thus India escaped the rigours of deflation to a much greater extent than other countries. On the other hand, as pointed out in the previous lecture, prices by themselves do not reflect the real nature and extent of deflation. It is only when cost is above prices either through depressed prices or inflated costs or both that we have deflation influencing the economic system. Adjustment really means to what extent prices and costs attained parity both in and outside India. In the words of Prof. Condliffe, “the parallel movement of the average price levels in different countries may be described as horizontal equilibrium. The harmonising, by international competition, of the different national

¹ H. S. Jevons—*The Future of Exchange and the Indian Currency*, p. 44.

price and cost structures may be described as the achievement of vertical equilibrium."¹

Cost and price relationship in the United Kingdom.

It has been already pointed out that for the United Kingdom the cost of living index may be taken as a fair measure of the cost of production. From Table No. 13 it will be seen that both prices and cost

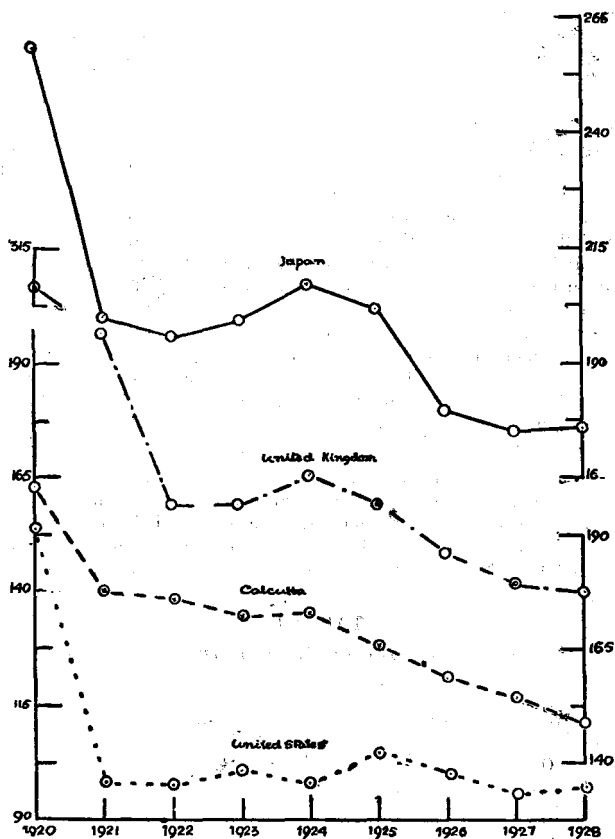
TABLE 12.
INDEX NUMBER OF WHOLESALE PRICES IN INDIA AND ABROAD.

Year	INDIA		U. K.		U. S. A.		JAPAN	
	Calcutta End of July, 1914=100		Board of Trade 1914=100		Bureau of Labour 1926=100		Bank of Japan 1913=100	
	Index No.	% fall from 1920 level	Index No.	% fall from 1920 level	Index No.	% fall from 1920 level	Index No.	% fall from 1920 level
1920	201	0	307	0	154	0	259	0
1921	178	11	197	36	98	36	200	23
1922	176	12	159	48	97	37	196	24
1923	172	14	159	48	101	34	199	23
1924	173	14	166	46	98	36	207	21
1925	166	17	159	48	104	32	202	22
1926	159	21	148	52	100	35	179	31
1927	154	23	142	54	95	38	170	34
1928	149	26	140	54	97	37	171	34

¹ *Index* (Stockholm), January, 1935, p. 3.

CHART VII.

INDEX NUMBER OF WHOLESALE PRICES IN INDIA AND ABROAD.



of living fell, the former falling more than the latter. An index of disparity between the two has also been worked out on the same plan as that adopted for India and discussed in Lecture II. There was a fall

in the United Kingdom index of disparity of 5 points from 1924 to 1925 and again from 1925 to 1926 and of 8 points from 1929 to 1930. It is quite evident that neither 1924 nor 1925 nor even 1926 was a normal year, although the conditions during any of these years were not so disturbed as in 1929 and 1930. On the other hand, it may be argued with equal force that during the entire range of four years 1926, 1927, 1928 and 1929 costs were about 85 per cent. of prices, whereas in 1924 and even in 1925, there were closer relationships in the shape of 97 per cent. and 92 per cent. respectively. In other words, economic strain must have been greater from 1926 to 1929 than in 1924 and 1925, which is contrary to what has been discussed so long. The fact of the matter is that it is not the absolute ratio between price index and cost of living index which is material. If during any period, this ratio rises or falls rapidly, there must be greater economic maladjustment than during any other when this ratio is stationary, even though at a lower level. The fall in the ratio from 1925 to 1926 is to be attributed mainly to the fall in the price of imported food and raw materials in Britain, after her return to the gold standard. The greater fall from 1929 to 1930 is due to the great depression. In the table below, Table No. 14, the disparity index is shown side by side with the "Economist" index of business activity (revised), which is supposed to reflect the fluctuation in the real income of the United Kingdom, and the British Board of Trade index number of industrial production, which is intended to measure the changes in the total output of industries.

The parallelism between these two series and their correspondence with the fluctuation in the disparity co-efficient are to be noticed. In any case, in reference to the fluctuations in the two index numbers for business activity and industrial production, it is clear that the years 1927-28 and 1928-29 show greater stability than any other period before or after.

TABLE 13.

WHOLESALE PRICES AND COST OF LIVING IN THE UNITED KINGDOM.

Year	Wholesale Price (Board of Trade)	Cost of Living (Ministry of Labour.)	Disparity [(2) ÷ (3)] × 100
(1)	(2)	(3)	(4)
1924	166	171	97
1925	159	173	92
1926	148	170	87
1927	142	164	86.5
1928	140	165	85.5
1929	137	163	84
1930	120	157	76

TABLE 14.
ECONOMIC ACTIVITY IN THE UNITED KINGDOM.

Year	Disparity between Price and Cost of Living	"Economist" Index No. of Business Activity (1935=100)	Board of Trade- Index No. of Indus- trial Production (1924=100)
1924	97	88	100
1925	92	89	..
1926	87	80.5	..
1927	86.5	95.5	107
1928	85.5	94	106
1929	84	98.5	112
1930	76	93	103
1931	70	87.5	94
1932	71	84	93
1933	72	89	99
1934	74	96	111

in the United Kingdom index of disparity of 5 points from 1924 to 1925 and again from 1925 to 1926 and of 8 points from 1929 to 1930. It is quite evident that neither 1924 nor 1925 nor even 1926 was a normal year, although the conditions during any of these years were not so disturbed as in 1929 and 1930. On the other hand, it may be argued with equal force that during the entire range of four years 1926, 1927, 1928 and 1929 costs were about 85 per cent. of prices, whereas in 1924 and even in 1925, there were closer relationships in the shape of 97 per cent. and 92 per cent. respectively. In other words, economic strain must have been greater from 1926 to 1929 than in 1924 and 1925, which is contrary to what has been discussed so long. The fact of the matter is that it is not the absolute ratio between price index and cost of living index which is material. If during any period, this ratio rises or falls rapidly, there must be greater economic maladjustment than during any other when this ratio is stationary, even though at a lower level. The fall in the ratio from 1925 to 1926 is to be attributed mainly to the fall in the price of imported food and raw materials in Britain, after her return to the gold standard. The greater fall from 1929 to 1930 is due to the great depression. In the table below, Table No. 14, the disparity index is shown side by side with the "Economist" index of business activity (revised), which is supposed to reflect the fluctuation in the real income of the United Kingdom, and the British Board of Trade index number of industrial production, which is intended to measure the changes in the total output of industries.

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Year	Disparity between Price and Cost of Living	"Economist" Index No. of Business Activity (1935=100)	Board of Trade- Index No. of Indus- trial Production (1924=100)
1924	97	88	100
1925	92	89	..
1926	87	80.5	..
1927	86.5	95.5	107
1928	85.5	94	106
1929	84	98.5	112
1930	76	93	103
1931	70	87.5	94
1932	71	84	93
1933	72	89	99
1934	74	96	111

LECTURE V.

PERIODS OF ADJUSTMENT AND OF COMPARATIVE STABILITY (1926-29): INTERNAL MEASURES.

In the last lecture, we considered some of the external factors which affected our currency system during the periods of adjustment and comparative stability. Not that there were no other factors, but it was thought advisable to emphasise only those which directly influenced our currency, both in matters of policy and of day-to-day administration.

Let us now consider the internal factors which affected our currency system during these periods. In India, as in western countries, there was a considerable improvement in the political and economic situation by the end of the year 1923-24. The decline of the Non-co-operation movement and of the Khilafat agitation during the early summer of 1922 meant a brighter political atmosphere, which had a favourable effect on Government budget which was anything but satisfactory during the quinquennium 1918-19 to 1922-23. These were years of unbalanced budgets, during which accumulated deficits reached no less a sum than Rs. 100 crores,¹ out of which Rs. 31 crores was covered by the creation of paper money, the remaining Rs. 69 crores being raised by loans. Included in the latter was Rs. 22 crores in the form of treasury bills issued to the public.

Balancing of the Budget.

The year 1923-24 was the first year of the balanced budget² of the Government of India after 1917-18. This was attained partly by retrenchment of expenditure on the lines of the recommendations of the Inchcape Committee and partly by fresh taxation. The balancing of the budget exerted a salutary influence on the Stock Exchange which became assured that currency inflation would no longer be resorted to, for covering deficits. This belief led to an increase in the price of Government securities.

Export surplus.

The balancing of the budget was preceded by a return of the favourable balance of trade in merchandise. This has been a normal feature

¹ This is the estimate given by Sir Basil Blackett in his Budget Statement for 1923-24 but it appears from Statement I in the Budget for 1924-25, p. 20 that the actual deficit was Rs. 98 crores.

² Any exaggerated importance should not however be given to this factor, as some of the provincial budgets were still in deficit.

of India's foreign trade from time immemorial and was disturbed only on two occasions during the last one hundred years, *viz.*, from 1856 to 1862 and again in 1920-21 and 1921-22. This return of the favourable balance of trade synchronised with an improvement of the rate of exchange which had sagged to the low level of 11 9/32*d.* (gold) in August, 1921.¹

Difficulties and uncertainties.

It may be naturally asked why adjustment could not be completed in India before 1927-28 in view of the fact that the world forces and Indian factors had been all acting in that direction for several years past. It may be more particularly argued that on England's return to the gold standard, there was *de facto* stabilisation of the rupee at 1*s.* 6*d.* gold from April, 1925. Leaving aside all economic issues for the present, there is the undoubted fact that in spite of this *de facto* stabilisation, there was considerable uncertainty as to the *de jure* stabilisation of the rupee at 1*s.* 6*d.* (gold) rate till the Currency Act (Act IV of 1927) received the assent of the Governor-General on the 26th March, 1927. It is hardly necessary to mention that throughout the year 1926-27, an active campaign for 1*s.* 4*d.* rupee had been carried on throughout the country and it was doubtful up to the very last moment whether the Currency Bill would be passed by the Legislative Assembly. It has already been pointed out that it is idle to talk of currency management or currency control, so long as the budget is not balanced. But even after 1923-24, when the central budget was, as we have seen, balanced, it is difficult to trace the objective of the currency authorities in India. The intention was clearly to deflate with a view to raise the exchange rate, but the pace and the extent were not clearly defined. The great expansion in currency and credit as well as in the basis of credit up to the year 1920 has already been mentioned. Several series of statistics are given below to show the extent and severity of the deflation since 1920.

Restriction of currency.

The first set of figures refers to the absorption of currency. It is common knowledge that normally India requires substantial amounts of additional currency, which amounted to nearly Rs. 12 crores² during the quinquennium preceding the war. The following table (Table No. 15) compiled from the annual reports of the Controller of Currency will explain the situation which is illustrated graphically in Chart VIII.

Regulation of credit.

Credit was also sought to be restricted at the same time. The monsoon of 1924 was satisfactory and when the seasonal demand for cur-

¹ Hilton Young Commission, Vol. II, p. 33.

² In Sir Cecil H. Kisch's evidence before the Hilton Young Commission, sovereigns and half-sovereigns were included, but it has been thought advisable to leave them out.

rency set in, the Imperial Bank rate was put up at 6 per cent. as early as October 16, 1924, several weeks before the setting in of the busy season in normal years. In order to estimate the effect of the brake put upon trade and industry through the bank rate policy in India, the average bank rate of the country is not so good a criterion as the difference between the average rates between the busy and slack seasons. For it is well known that it is only during the busy season that the Indian bank rate is effective, whereas during the slack season the rate is nominal, trade and even industry¹ being financed largely through indigenous credit organisations. The average Imperial Bank rate (and subsequently the Reserve Bank rate) for the 1st and 2nd half years roughly comprising the busy and slack seasons, as well as their difference and the average for the whole year, are shown in Table No. 16 and Chart IX. In the last

TABLE 15.

ABSORPTION OF VARIOUS FORMS OF INDIAN CURRENCY.

(Data from *Annual Reports of Controller of the Currency.*)

Year	Absorption of Rupees. (Rs. Crores)	Absorption of Notes in active circulation (Rs. Crores)	Total Absorption (Rs. Crores)
Average for the quinquennium 1909-10 to 1913-14.	8.8	3.0	11.8
Average for the years 1914-15 to 1918-19.	22.1	16.7	38.8
1918-19	45.0	49.3	94.3
19-20	20.1	20.2	40.3
20-21	-25.7*	-5.9*	-31.6*
21-22	-10.5*	9.4	-1.1*
22-23	-9.6*	3.9	-5.7*
23-24	7.6	8.0	15.6
24-25	3.7	-2.5*	1.1
25-26	-8.2*	1.2	-7.0*
26-27	-20.0*	-3.4*	-23.4*
27-28	-3.8*	10.2	6.5
28-29	-3.0*	3.6	0.6

¹ It is a common and unhappy feature of Indian industrial finance that "deposits" are accepted from private persons and bankers both for long-term and short-term needs.

* Minus indicates withdrawal from circulation.

CHART VIII.
ABSORPTION OF CURRENCY.

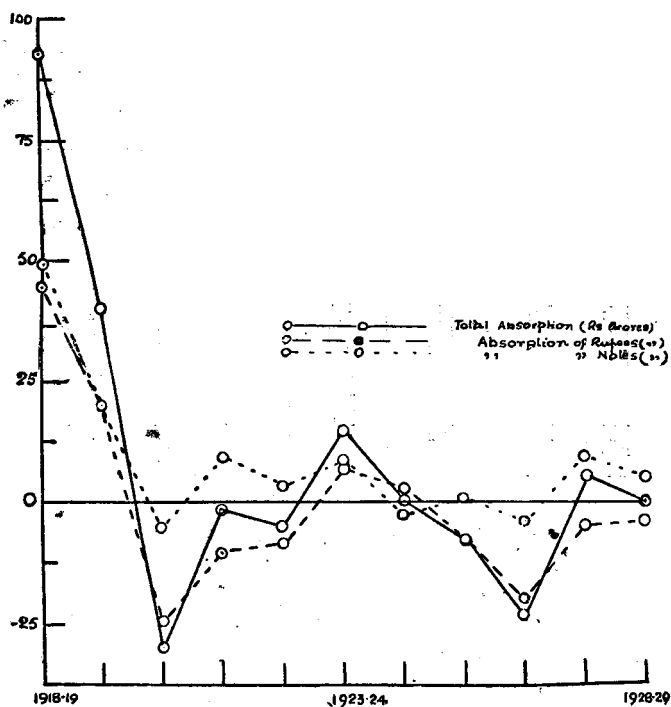


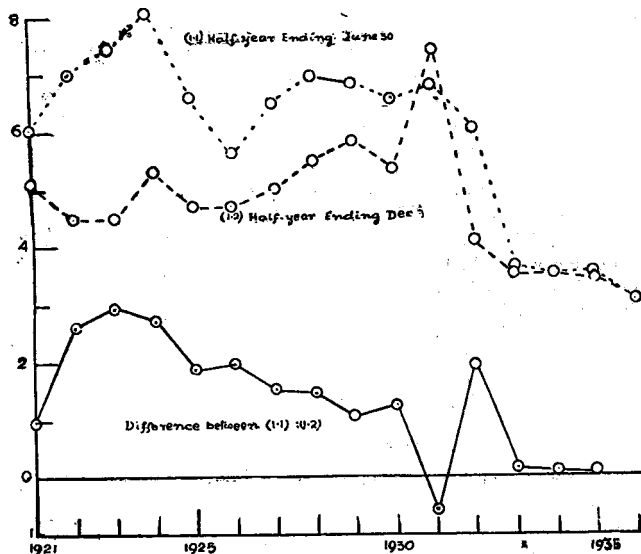
TABLE 16.

INDIAN BANK RATE.¹(Data from *Statistical Tables relating to Banks in India.*)

Year.	Half year ending June 30.	Half year ending December 31.	Annual average. $\left[\frac{(2)+(3)}{2} \right]$	Difference bet. the rates for two half years, (2)-(3)	Proportion of difference to annual average rate. $[(5) \div (4)] \times 100.$
(1)	(2)	(3)	=(4)	=(5)	(6)
1921	6'04	5'11	5'57	0'93	17%
1922	7'13	4'51	5'81	2'62	45%
1923	7'42	4'50	5'96	2'92	49%
1924	8'05	5'32	6'68	2'73	41%
1925	6'58	4'70	5'64	1'88	33%
1926	5'65	4'70	5'17	1'95	38%
1927	6'51	4'96	5'73	1'55	27%
1928	6'94	5'46	6'20	1'48	24%
1929	6'88	5'79	6'33	1'09	17%
1930	6'51	5'28	5'89	1'23	21%
1931	6'74	7'35	7'04	-61	-9%
1932	6'02	4'03	5'03	1'99	40%
1933	3'63	3'50	3'56	0'13	4%
1934	3'50	3'50	3'50	..	0%
1935	3'50	3'42	3'46	..08	2½%
1936	3'00	3'00	3'00	..	0%

¹ Imperial Bank rate up to the end of June, 1935 and Reserve Bank of India rate from July, 1935. Whereas the bank rate of the Reserve Bank of India and of Central Banks in other countries denotes the rate of discount, the bank rate of the Imperial Bank of India was the rate at which it "ordinarily advanced money against Government securities". This however does not really mean any important difference because the Imperial Bank *Hundi* rate at which the Bank discounts first class bills, has generally been identical with the official bank rate.

CHART IX:
INDIAN BANK RATE.



column, the difference has been expressed as a percentage of the annual average to make the figures mutually comparable. For instance, during 1924 the difference is 2.73 and during 1932 it is only 1.99, but they are of the same order, for the former has to be computed with reference to 6.68 and the latter to 5.03.

Disparity between spot and forward exchange rates.

Another and probably a more satisfactory measure of the seasonal demand for currency is afforded by the discount of forward rates below ready rates during the busy season.¹ Thus in India when business is brisk, the rate of interest is higher than in London. It is therefore profitable for exchange banks in India to borrow money in the London money market and employ it in loans in India. When the slack season sets in, the *contra* operation is performed and the London and Indian accounts are adjusted. Thus during the busy season, exchange banks are anxious

¹ Forward Exchange in Indian Banks by Dr. H. Sinha in the *Indian Journal of Economics*, Vol. V. See also his article on Seasonal Fluctuations in the Indian Bank Rate and The Remedy in *Bankers Magazine* (London) October, 1924.

to have rupees in exchange for sterling, whereas during the slack season they desire to have sterling in exchange for rupees. Thus when there is stringency in the Indian money market, exchange banks quote a higher rate in sterling for spot or ready sale than for a forward sale. Let us take an actual example. In the money article of the *Statesman* (Calcutta) for February 1, 1925, it is stated:—

“The forward position has not shown much variation during the week. There is a discount of approximately $1\frac{1}{16}$ th per month for February to May positions.” Spot T.T. selling rate at the time was 1s. 6d. and 1 month Forward, *i.e.*, February rate was 1s. 5 $\frac{15}{16}$ d., March rate 1s. 5 $\frac{7}{8}$ d. and so on. It may be noted here that money rates were comparatively high in India at the time. The Imperial Bank rate was as high as 7 per cent. while the discount rate for 3 m¹st bank bills in London was 3 $\frac{13}{16}$ per cent. Such disparity between ready and forward rates would have furnished a good index of seasonal stringency. Unfortunately, however, forward exchange rates are not available in any of the official publications. Even in non-official market reports, they are not to be found in a convenient and systematic manner. It has therefore not been possible to utilise this index for analysing the monetary situation in India.

Open market operations.

As regards open market operations, it is not customary for the Imperial Bank to engage in buying and selling securities on a large scale. As is well known, their effect is two-fold. The short period effect is to inject (or withdraw) loanable funds in the short-term market. The long period effect is to lower (or raise) the short-term rate of interest through the immediate lowering (or raising) of the long-term rate. If we study the figures for investments of the Imperial Bank of India, or the trend of the price of Government securities (the reciprocal of which roughly shows the trend of long-term rate), we find there is no conscious attempt at management. Relevant figures are subjoined in Table No. 17.

Indirect deflationary measures.

Hitherto we have discussed the direct deflationary measures with a view to depress prices. Reference may also be made to indirect deflationary measures resulting in increased costs. For, as has been made clear in previous lectures, the effect of a fall in the price level, the cost level remaining the same resembles the effect of a rise in the cost level, the price level remaining the same. There was no substantial relief to taxation even after the budget was balanced. The reduction of the excise duty on petrol during 1924-25, the remission of the cotton excise duty in 1925-26, the abolition of the stamp duty on cheques during 1927-28,

TABLE 17.
INVESTMENTS OF THE IMPERIAL BANK OF INDIA.

Year.	Investments* of the Imperial Bank of India on Dec. 31 (Rs. Crores.)	Discount** during December on 3½% guaranteed paper below par
1920	..	Rs. A. 47-10
1921	12.5	40-1
1922	9.8	41-15½
1923	12.2	37-1
1924	16.4	34-1
1925	17.0	31-4
1926	19.2	21-10
1927	18.6	25-1
1928	21.8	27-8
1929	33.0	32-2
1930	29.3	35-15
1931	30.3	47-13
1932	32.0	27-0
1933	47.0	18-9

the small reduction in railway rates in that year, the small and ungenerous relief to provinces—all these and similar measures did not and could not reduce the high level of costs. High bank rate and high bond rate also operated in the same direction, apart from their immediate effect of credit contraction and price depression already mentioned.

Fixation of the standard.

It now remains for us to describe the improvement in the financial machinery achieved during the period of adjustment. In the first place, the question of the standard, which, as we have seen, perplexed the currency authorities even in the days of Clive,—that question was decided by the adoption of the gold bullion standard. We do not desire to take up at this stage the question of the ratio, which will be considered later on at the time of the appraisal of currency measures adopted during the periods of adjustment and comparative stability. We are here concerned with the fact that a legal relation was set up between gold and our rupee by the Indian Currency Act of 1927. Before the passing of this Act, there was no statutory liability on the part of Government to sell Reverse Councils or to purchase sterling at certain definite rates. In the new system, the purchase and sale of gold bars by Government were apparently made compulsory. But the wide difference between the buying and selling rates amounting to as much as 2.3 per cent. did not make the link rigid but elastic. Hawtrey criticised this severely and went on as far as to say that the name gold bullion standard given to the standard was a misnomer. Probably he is right. In any case, the intention of the authorities was clearly not to give

* Data from *Statistical Tables Relating to Banks in India*.

** Data from *Statistical Abstract for British India*.

gold in exchange for the rupee except in cases of dire necessity. The demonetisation of sovereigns in India under the Currency Act of 1927, was also a step in the same direction. On the other hand, in the light of subsequent monetary theory, this unwillingness to give gold was not an unmixed evil. The gap between buying and selling rates may be utilised in shutting out external influences. To be able to insulate our monetary system from disturbances outside is no small gain. The evils of a fluctuating exchange could be remedied in the case of India with the help of well organised markets in forward exchanges in Calcutta and Bombay. We had adequate reserves and sufficient credit in the London Money Market to enable us to face with equanimity temporarily adverse exchanges.

Branches of the Imperial Bank.

In the second place, the Imperial Bank of India was opening up new branches and not only extending banking facilities to remote areas but also taking steps to link up with organised banking indigenous banking in those areas. By March 31, 1925, as many as 80 branches had been opened up and within the next year 22 more were opened, thus more than fulfilling the programme.

Transfer of funds.

Another service afforded by the Imperial Bank was with regard to transfer of funds. The maximum rate for transfers of amounts not below Rs. 10,000 was fixed at 1 anna per Rs. 100, but during 1924-25, the rate for banks was fixed at $\frac{1}{2}$ anna per Rs. 100. The extent to which these facilities were availed of will appear from Table No. 18.

It has been thought advisable to give detailed figures, circle by circle, for a number of years, because not only do they show the extent of the facilities afforded by the Imperial Bank, they also give some indication with regard to the financing of trade. In order to show the seasonal swings, the figures for the two half-years are shown separately, the former roughly corresponding to the busy season and the latter to the slack season. We say "roughly" advisedly, for the seasons depend largely on the monsoon, which does not break in at the same time year by year. Another disturbing factor is that remittance of funds is effected not only for trade purposes but also for financial reasons, specially between centres like Calcutta and Bombay where we have important Stock Exchanges.

Emergency currency.

As is well known, in the report of Babington Smith Currency Committee (paragraph 80) there was a recommendation about issue of additional currency during the busy season against the security of bills of exchange to the Imperial Bank of India. This was implemented by

TABLE 18.

REMITTANCE OF FUNDS THROUGH THE IMPERIAL BANK OF INDIA.

(Data from the Report of the Controller of Currency.)

(Rs. Crores.)

		Demand Drafts Purchased.				Drafts and T.T's Sold.			
Year.		Bengal Circle.	Bombay Circle.	Madras Circle.	Total.	Bengal Circle.	Bombay Circle.	Madras Circle.	Total.
1920	1st half	14.21	4.39	12.58	31.18	12.14	5.48	7.03	24.65
	2nd "	5.10	4.78	10.31	20.19	18.95	16.71	9.31	42.97
1921	1st "	17.36	9.72	10.95	38.03	17.42	17.15	8.82	43.39
	2nd "	9.65	9.50	13.29	32.44	22.64	21.80	10.16	54.60
1922	1st "	18.68	11.00	11.75	41.73	24.54	20.02	7.47	52.03
	2nd "	16.13	18.92	16.30	51.35	22.34	26.38	9.39	58.11
1923	1st "	27.07	18.91	10.50	56.48	22.80	25.03	9.30	57.13
	2nd "	23.66	28.66	18.30	70.62	26.90	30.94	12.43	70.36
1924	1st "	33.54	17.84	12.55	63.93	34.31	27.10	9.96	71.37
	2nd "	29.93	34.54	19.59	84.06	38.57	35.74	11.62	85.93
1925	1st "	38.70	20.55	13.71	72.96	45.53	30.93	11.55	88.01
	2nd "	23.57	27.38	15.37	66.32	50.71	29.85	11.80	92.36
1926	1st "	28.95	15.98	12.29	57.22	41.48	27.31	10.33	79.12
	2nd "	26.52	24.56	17.48	68.56	38.79	29.36	11.14	79.29
1927	1st "	34.04	21.27	15.55	70.86	37.36	29.41	9.80	76.57
	2nd "	31.48	30.20	21.55	83.23	32.87	30.49	11.29	74.65
1928	1st "	34.10	22.09	16.30	72.49	39.73	29.52	14.00	80.25
	2nd "	24.25	33.93	22.17	80.35	38.31	38.15	13.94	90.40
1929	1st "	27.09	23.29	17.48	67.86	34.18	31.14	11.62	76.94
	2nd "	23.34	23.89	13.92	61.15	34.96	33.11	12.31	80.38
1930	1st "	20.39	14.51	10.74	45.64	29.21	32.16	11.20	72.57
	2nd "	17.45	16.48	10.07	44.00	31.52	34.74	13.71	79.97
1931	1st "	17.86	12.32	6.88	37.06	27.10	30.87	14.93	72.90
	2nd "	19.86	17.41	7.61	44.88	32.43	29.68	14.06	76.17
1932	1st "	19.29	12.57	8.64	40.50	28.12	25.97	10.94	65.03
	2nd "	19.08	19.18	9.14	47.40	30.58	29.41	13.54	73.53
1933	1st "	16.59	10.87	5.96	33.42	29.09	22.49	11.57	63.15
	2nd "	21.67	15.50	8.84	46.01	33.23	26.87	15.70	75.80
1934	1st "	19.17	10.61	6.49	36.81	28.54	25.49	17.79	71.82

Section 14 of the Indian Paper Currency Amendment Act, 1920, fixing Rs. 5 crores as the limit of emergency currency. The rules framed by the Government of India laid down that the bills must be internal bills or *hundis*, drawn for genuine trade purposes. A minimum rate of 8 per cent. was prescribed. The first loan of Rs. 2 crores was taken on March 10, 1921, and repaid on April 27 next. These conditions were found to be too onerous, and the Indian Paper Currency Act was amended by Act XXVI of 1923 which received the assent of the Governor-General on August 3, 1923. This Act provided for issue of emergency currency at the following minimum rates:

6 per cent. for the first four crores of rupees.

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1920	1st half	..	..	..	..	..	..	..	..
	2nd "	14.21	4.39	12.58	31.18	12.14	5.48	7.03	24.65
1921	1st "	5.10	4.78	10.31	20.19	18.95	16.71	9.31	42.97
	2nd "	17.36	9.72	10.95	38.03	17.42	17.15	8.82	43.39
1922	1st "	9.65	9.50	13.29	32.44	22.64	21.80	10.16	54.60
	2nd "	18.68	11.00	11.75	41.73	24.54	20.02	7.47	52.03
1923	1st "	16.13	18.92	16.30	51.35	22.34	26.38	9.39	58.11
	2nd "	27.07	18.91	10.50	56.48	22.80	25.03	9.30	57.13
1924	1st "	23.66	28.66	18.30	70.62	26.90	30.94	12.43	70.36
	2nd "	33.54	17.84	12.55	63.93	34.31	27.10	9.96	71.37
1925	1st "	29.93	34.54	19.59	84.06	38.57	35.74	11.62	85.93
	2nd "	38.70	20.55	13.71	72.96	45.53	30.93	11.55	88.01
1926	1st "	23.57	27.38	15.37	66.32	50.71	29.85	11.80	92.36
	2nd "	28.95	15.98	12.29	57.22	41.48	27.31	10.33	79.12
1927	1st "	26.52	24.56	17.48	68.56	38.79	29.36	11.14	79.29
	2nd "	34.04	21.27	15.55	70.86	37.36	29.41	9.80	76.57
1928	1st "	31.48	30.20	21.55	83.23	32.87	30.49	11.29	74.65
	2nd "	34.10	22.09	16.30	72.49	39.73	29.52	14.00	80.25
1929	1st "	24.25	33.93	22.17	80.35	38.31	38.15	13.94	90.40
	2nd "	27.09	23.29	17.48	67.86	34.18	31.14	11.62	76.94
1930	1st "	23.34	23.89	13.92	61.15	34.96	33.11	12.31	80.38
	2nd "	20.39	14.51	10.74	45.64	29.21	32.16	11.20	72.57
1931	1st "	17.45	16.48	10.07	44.00	31.52	34.74	13.71	79.97
	2nd "	17.86	12.32	6.88	37.06	27.10	30.87	14.93	72.90
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1933	1st "	19.08	19.18	9.14	47.40	30.58	29.41	13.54	73.53
	2nd "	16.59	10.87	5.96	33.42	29.09	22.49	11.57	63.15
1934	1st "	21.67	15.50	8.84	46.01	33.23	26.87	15.70	75.80
	2nd "	19.17	10.61	6.49	36.81	28.54	25.49	17.79	71.82

Section 14 of the Indian Paper Currency Amendment Act, 1920, fixing Rs. 5 crores as the limit of emergency currency. The rules framed by the Government of India laid down that the bills must be internal bills or *hundis*, drawn for genuine trade purposes. A minimum rate of 8 per cent. was prescribed. The first loan of Rs. 2 crores was taken on March 10, 1921, and repaid on April 27 next. These conditions were found to be too onerous, and the Indian Paper Currency Act was amended by Act XXVI of 1923 which received the assent of the Governor-General on August 3, 1923. This Act provided for issue of emergency currency at the following minimum rates:

6 per cent. for the first four crores of rupees.

7 per cent. for the second four crores of rupees.

8 per cent. for the third four crores of rupees.

Subsequently in September, 1924, the rules were further relaxed, laying down a minimum rate of 6 per cent. for the first four crores as before, but prescribing a minimum rate of 7 per cent. for the remaining 8 crores. This was very timely, for it was during 1923-24 that the Imperial Bank rate went up to 9 per cent., a rate never reached before or after.¹ The Bank's hundi rate also went up to 9 per cent., the Bazar rate reaching 13½ per cent. in Bombay.

Proportional reserve in place of fixed fiduciary system.

Early in 1925, arrangement for further expansion of paper currency was made by Act II of 1925, which received the assent of the Governor-General on February 11, 1925, raising the limit of the fiduciary issue from Rs. 85 crores to Rs. 100 crores, and prescribing a limit of Rs. 50 crores for "created" securities. This measure provided for permanent expansion of currency. This fixed fiduciary principle was abandoned as is well known, in the permanent provisions of the Paper Currency Act of 1923 and also in the system of Reserve Bank note-issue, as recommended by the Hilton Young Commission. The alleged grounds for preference of the proportional reserve system is that under it the method of expansion is easier but the process of contraction is made more difficult than under the other system. It has therefore been argued that countries which produce large quantity of agricultural goods and are consequently liable to require a large increase of currency in the harvesting season, a quickly expanding system under proportional reserve is better whereas for a country like England which lays itself open to large and sudden demands for gold, a less elastic system of fixed fiduciary issue is more suitable. The Hilton Young Commission gives another argument in favour of the proportional reserve system. According to them "the fixed fiduciary system can only work satisfactorily where the chief medium of payment is not the note but the cheque". But if economic stability is the aim of the currency authority, the fixed fiduciary system, with a fairly high limit for fiduciary issue, as has been adopted in England under the Act of 1928, is certainly better, for the proportional reserve system may make economic stability more difficult of attainment. On the other hand, a country can fix a limit for fiduciary issue when it has attained a steady stage in economic development and not when it is rapidly expanding its economic life, for then only can the currency authority know the amount of notes which will remain in the pockets of people and tills of shop-keepers and will not ordinarily

¹ Before the advent of the Imperial Bank of India, the last occasion on which the bank rate rose to 9 per cent. both in Calcutta and Bombay, was as far back as 1908, though the rate reached that level in Bombay and Madras for a short time in 1920.

be handed for conversion. From this point of view, proportional reserve system is to be preferred in the case of India. To sum up, the difference between the proportional reserve system with provision for additional issues under penalty, if the reserve falls low and the new form of fixed fiduciary system with the securities limit considerably higher than normal requirements, is now so narrow that any detailed discussion on their relative merits is unnecessary.

Sterling purchase in India.

During the year 1923-24, a system of sterling purchase in India was substituted for the sale of Council Bills in London. When introducing the Indian Paper Currency Bill in the Legislative Assembly on January 22, 1925, the late Sir Basil Blackett stated:

"Our purchases of sterling have enabled us to ease the market in two ways. First of all the rupees we paid out for purchases of sterling, were available for the banks and others for the purpose of re-lending. . . . In addition, in order to put the Government of India in funds with which to purchase sterling and also to increase the amount of currency available for general trade purposes in India, the Government of India have to the extent of Rs. 6 crores already added to the amount of currency in India by transferring money from the Secretary of State's balances to the Paper Currency Reserve in London and issuing rupees against it." It appears however that both of these might be equally well achieved through the sale of Council Bills in London.

The reason assigned by Sir Cecil Kisch for this innovation before the Hilton Young Commission (Vol. III, p. 482) was "an undesirable up-rush of exchange," but he did not make it clear in what way sterling purchase in India was superior to Council Bill sales in London in this respect. He pointed out two defects:—

(a) purchases in India "involve correlation of demands from various centres remote from each other and the headquarters of Government. This cannot be as simple or expeditious as the receipt and disposal in London of tenders from the head offices of the Exchange Banks and other leading institutions and firms generally situated in close proximity to the Bank of England".

(b) "in the case of Council sales in London, rupees are not issued until the Secretary of State in Council has been paid in sterling. In the case of purchase of sterling in India, the rupees are credited before the sterling has been paid over to Government."

As regards the first, the complaint rather was that the tender for Council sales was restricted to a small coterie and full and free competition was not available for the most remunerative rate of

exchange. The second objection was valid. Equally valid was the objection against the omission of ample notice and proper publicity for tenders of sterling purchases in India in the initial stages. The latter was rectified with effect from April, 1927. Sometime before that Council Sales came to be abandoned. In fact, as pointed out in the *Report of the Controller of Currency* for 1923-24 (p. 11), "the factors influencing the immediate course of exchange can be gauged more accurately and more promptly in India, and by regulating the purchases with reference to the varying conditions of the market, the operations of Government could be conducted so as to avoid violent fluctuations in rates with benefit both to trade and to the country generally."

New upcountry currency chests.

Another device for securing economy and mobility of currency was to set up additional currency chests at sub-treasuries. During the seasons of heavy revenue collection, surplus funds were transferred from treasury chests into the local currency chests, corresponding amount being released at headquarters from currency chests into treasury chests. Thus the delay, risk and expense of remittance of funds were avoided. Similarly when there was a need for additional crop-moving funds in the mofussil, funds were released from local currency chests into treasury chests, a *contra* transfer being effected at headquarters. Thus on April 1, 1920 there were only 342 chests at sub-treasuries and as many as 423 on March 31, 1921. The effect of this measure in economising locked-up funds in sub-treasuries will be apparent from the following table:—

TABLE 19.

GOVERNMENT BALANCES AT TREASURIES AND SUB-TREASURIES OTHER THAN THOSE MANAGED BY THE IMPERIAL BANK OF INDIA.

(Data from the *Report of the Controller of Currency*.)

Year.	Annual Average.
	Rs. lakhs.
1919-20	6.80
1920-21	6.25
1921-22	5.09
1922-23	4.00
1923-24	3.40
1924-25	2.95
1925-26	2.67
1926-27	2.48

Sterling resources in P. C. R.

A similar transference of funds between the Paper Currency Reserve and the Secretary of State's balances in London secures similar mobility and elasticity in our currency system. One instance of this was given by the late Sir Basil Blackett on January 22, 1925 in the Indian Legislative Assembly as already mentioned. Another instance occurred during 1928-29. £6 millions India Bills with a maturity of six months were issued in August, and a sterling loan of £10 millions was floated in January. Notes were issued during the busy season against these sterling securities in London. During 1925-26, there was an issue of Rs. 2 crores in October and of Rs. 7 crores in November and December against British Treasury Bills, thus mitigating the difficulties of seasonal demand for currency. Similar transfers were also made from time to time when the remittance programme of Government could not be fulfilled owing to the weakness in exchange, and funds held in the Paper Currency Reserve in London had to be utilised by the Secretary of State. This was done either for deflation or for remittance,¹ and not for any temporary adjustment of circulation of currency in accordance with trade needs,—and has therefore not been discussed here.

Was such severe deflation necessary?

The question now arises whether the severe and coercive measures of deflation referred to above, were really necessary. The popular view is that a too high external value was given to the rupee by the Hilton Young Commission and our economic system had to be unduly strained to attain this artificially high value. We have already seen that the arguments on which the Hilton Young Commission based their conclusion are not theoretically valid. In any case, it is frequently found that a disease which could not be properly diagnosed or cured even by an expert doctor may be correctly revealed by a post-mortem examination. We recognise that "it is easy to be wise after the event," but to a student of Economics it is a source of abiding pleasure to apply his theories to present day conditions and test their validity.

Over-valuation and under-valuation.

The question of over-valuation and under-valuation of the rupee has been examined by many economists, business men and administrators but the sense in which the term 'over-valuation' or 'under-valuation' has been used is by no means quite clear. To speak broadly, every currency has two kinds of value, *viz.*, its internal value and its external value. The former is the command over goods and services within the country.

¹ A recent instance of such remittance occurred in 1934-35. See Controller of Currency Report for the year, p. 12.

The latter is the command over goods and services in a foreign country which may be obtained by spending our national currency. Though there is a tendency for these two values to become identical, there is no guarantee that they would be in adjustment within a short period, in view of the rigidity of the economic structure, especially in the post-war world. Thus the rupee is over-valued where it buys more goods and services abroad than at home. Such a definition does not however carry us far.

Purchasing power parity theory and its underlying assumptions.

According to Prof. Cassel, over-valuation or under-valuation of a currency may be easily detected by referring to purchasing power parity. If the current rate of exchange is *higher* than the purchasing power parity, when the exchange rate is quoted in foreign units to a unit of home currency, as in the case of the rupee-sterling exchange, there is definite over-valuation. If, on the other hand, the current rate of exchange is *lower* than purchasing power parity, there is under-valuation. But Cassel's device for calculating such parity holds good only on certain assumptions, the most important of which are (a) that the index number of prices chosen accurately represents the purchasing power of money in the two countries and (b) that the barter term of trade has remained unchanged.

This second assumption was, broadly speaking, valid for our country in 1925-26. It will appear from Table 20 that the net barter term of trade in 1925-26 was practically the same as that in 1927-29 and was not materially different from that in the pre-war year 1913-14.

Wholesale price parity.

If we now apply the theory of the purchasing power parity, based on general wholesale index number of prices, as suggested by Cassel, we find from Table 20 that the proper rate of exchange for 1925-26, on the assumption of there being normal condition during the years 1927-28 and 1928-29 to be:—

$$\left(\frac{154 \times 100}{139.5} + \frac{157 \times 100}{146} \right) \times 17.97d^1 = 18.5d.$$

If, on the other hand, we proceed on the basis of the pre-war equilibrium period when the exchange rate was 16d. approximately, the parity rate for 1925-26 was:—

$$\frac{154}{157} \times 16d. = 15.7d.$$

The reason for this wide discrepancy is partly due to the fact that wholesale index numbers do not accurately represent the purchasing power of money either in England or in India.

¹ During the two years 1927-28 and 1928-29, the observed exchange rate was 17.97d., which represents the average of the weekly quotations for the T. T. selling rate, published in the *Indian Trade Journal*.

TABLE 20.

TERMS OF TRADE AND WHOLESALE AND COST OF LIVING INDICES.

April to March.	India.				England.	
	Net barter terms of trade 1913-14=100.	Gross barter terms of trade 1913-14=100.	Calcutta Wholesale Index No. July 1914=100.	Bombay Cost of Living Index No. July, 1914=100.	British Board of Trade Wholesale Index No. 1913=100.	Ministry of Labour Cost of Living Index No. 1914=100.
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1925-26	96.2	77.5	157	154	154	172
27-28	95.6	97.3	147	152	140	169
28-29	95.5	97.4	145	147	139	166
Average for 1927-29	95.6	97.4	146	149.5	139.5	167.5

Consumption standard parity.

If we mean by the purchasing power of money "the power of money to buy goods and services on the purchase of which for purposes of consumption a given community of individuals expend their money income", as suggested by Keynes,¹ the Consumption Standard should be used for calculating the purchasing power parity. Snyder has suggested the following composite index with weights and components given below, for measuring the purchasing power of money in England:—

Board of Trade Wholesale Prices	.. 2
Ministry of Labour Cost of Living	.. 3½
Bowley's Wages Index	.. 3½
Rent	.. ½

According to Keynes, this composite index "provides as good a Consumption Index for Great Britain as is practicable in the present state of our statistical knowledge". Any index number, approaching such composite index, is not available for India. There are special difficulties in compiling a Consumption Standard for India which we propose to examine in the concluding lecture. For the present, we may only suggest the Bombay Cost of Living index gives a better idea of the Consumption Standard for India than the Calcutta wholesale prices index. In order that the manner of the construction of the index for

¹ J. M. Keynes—*A Treatise on Money*, Vol. I, p. 54.

the United Kingdom may be as much similar as possible to the method of construction followed in India, we have thought it advisable to take the Ministry of Labour Cost of Living index for the United Kingdom. If that is done, the parity rate for 1925-26 becomes—

(a) on the assumption of there being a normal period during 1927 to 1929,

$$\left(\frac{172 \times 100}{167 \cdot 5} \div \frac{154 \times 100}{149 \cdot 5} \right) \times 17 \cdot 97d = 17 \cdot 92d.$$

(b) on the assumption of there being a normal period in the pre-war year,

$$\frac{172}{154} \times 16d = 17 \cdot 87.$$

These two are not so much apart as those obtained above on the basis of wholesale indices.

The years 1927-29, a period of equilibrium.

We have now to test whether there was in fact a proper adjustment between exchange and prices during the two years 1927-28 and 1928-29 which we have sought to establish as an equilibrium period, largely on *a priori* grounds, during the last three lectures. In other words, we should be able to derive a parity rate for 1927-29 on the basis of the actual rate in 1913-14. If that is done, the parity rate becomes on the

basis of cost of living indices $\frac{167 \cdot 5}{149 \cdot 5} \times 16d$ or $17 \cdot 26d$, which does not

appreciably differ from the observed exchange rate of 17·97, specially when we remember that the barter term of trade was then 95·6 in place of the pre-war figure of 100.

The Hilton Young ratio.

It appears from the above analysis that the exchange rate was not put at an unduly high level by the Hilton Young Commission. Their mistake lay in the fact that they stabilised the exchange when the time was not quite ripe for stabilisation. It is a pity that the error of the Babington Smith Committee in attempting exchange stabilisation when the economic condition, both in India and abroad, was far from normal, was repeated only after six years. In the previous lecture we have shown how unsettled the world conditions were at the time. In India also there was great instability. On reference to Table No. 10 it will be seen that the net term of trade rose from 85·6 in 1924-25 to 96·2 in 1925-26 and fell to 89·2 in the next year. The gross barter terms of trade during these three years were respectively 73·1, 77·5 and 91·2. How seriously out of joint India's balance of accounts was, will also appear from the following table (No. 21) summarised from the *Report of the Controller of Currency* for 1926-27. During 1926-27, the export surplus was small, nor could remittance to London be effected.

Apart from these, the visible balance of accounts was very unsteady as shown in the last line of the table, calling for large capital movements.

At this distance of time, things can be seen at a proper perspective. The relative values of economic events have also considerably changed. Even when these are conceded, it is rather unfortunate that the rupee was sought to be stabilised in such a troubled period. The strain for the maintenance of exchange began to be felt almost immediately not because the exchange rate was fixed too high as popularly supposed, but because there were grave economic disorders to be reckoned with both at home and abroad.

TABLE 21.

INDIA'S VISIBLE BALANCE OF ACCOUNTS (IN CRORES OF RUPEES).

[Data from the *Report of the Controller of Currency.*]

+ indicates net export and — indicates net import.

	Average of 5 years ending 1913-14.	Average of 5 years ending 1918-19.	Average of 5 years ending 1923-24.	1924-25	1925-26	1926-27
Balance of trade in merchandise on private account.	+78	+76	+52	+1,55	+1,61	+79
Gold on private account and entering into balance of trade.	-29	-8	-14	-74	-35	-19
Silver ditto.	-7	-3	-12	-20	-17	-20
Total Visible Balance of Trade.	+42	+65	+26	+61	+1,09	+40
Council sales, sterling purchases and similar transfers.	-41	-35	-15	-56	-61	-3
Reverse Councils and similar transfers.	..	+6	+9	..	..	+2
Transfers of Government securities and remittance through interest drafts on securities.	-1	-1	..	-1	-2	..
Balance of remittances of funds.	-42	-30	-6	-57	-63	-1
Total Visible Balance of Accounts.		+35	+20	+4	+46	+39

LECTURE VI.

PERIOD OF STRAIN AND CRISIS: (APRIL TO SEPTEMBER, 1929).

In the last two lectures, we considered some of the external and internal factors which influenced our currency system during the periods of adjustment and comparative stability. We desire to emphasise once again the fact which we have already mentioned, *viz.*, that during the years 1927-28 and 1928-29, we had only comparative stability, not absolute stability. In other words all the factors, both external and internal, influencing our currency system were not in complete equilibrium. All that we mean is that they were in better adjustment during these two years than they were at any other period during or after the War.

It is therefore difficult to estimate exactly when this equilibrium came to be upset. It is an undoubted fact that there must have been a period of strain before the great depression. The question is, when did it first begin to be felt in India? For, in its early phase, it was very slow—almost imperceptible except to a discerning eye. This however, is certain that it did not begin in India at the same time nor in the same manner as in other countries.

Signs of depression in agricultural and manufacturing countries.

The actual incidence of depression in a country is to be inferred from the diminution in the national income. For advanced industrial countries, employment and production figures roughly indicate the trend of national income whereas for backward agricultural countries, harvest returns, export values and barter terms of trade have to be utilised for the same purpose, for agricultural output might even increase during a depression. Thus New Zealand's troubles during the last slump was primarily due to a worsening in her terms of trade. Though her volume of production in 1933 was higher than in 1928, the quantity of goods available for consumption was 26 per cent. lower than in 1928. According to the *Report of the Monetary Committee of New Zealand* (1934), this real loss was "due principally to—(a) Having to set aside a larger quantity of produce to meet fixed obligations overseas; and (b) the fact that the terms of barter in Great Britain have gone against us, with the result that in exchange for a given quantity of primary products we now receive less manufactured goods than formerly—that is to say, the prices of primary products have fallen more than the prices of manufactured goods." India experienced also the same troubles due to adverse move-

ments¹ in her terms of trade during the periods of strain and depression. Even in 1932-33, when the lowest point of the depression was reached in India, her volume of crop production was the same as in 1928-29.²

When did India and other countries of the world first begin to feel the strain prior to the great depression? In an instructive chart given in the *World Economic Survey*, 1931-32 (League of Nations), the following dates are assigned for the beginning of the depression in countries with which India has important trade relations or in which India is otherwise interested:—

Year.	Quarter.	Countries.
1927	IV	Australia, Dutch East Indies.
1928	I	Germany (the temporary revival after the strike in 1928 IV, may be ignored).
1929	II	Argentina, Canada.
1929	III	Belgium, Egypt, Italy, U.S.A.
1929	IV	Austria, India.
1930	I	Japan, South Africa, United Kingdom.
1930	II	France.

¹ But it is not implied that the worsening of the term of trade is always an indication of national loss or that its improvement is in every case an index of national gain. As Keynes pointed out in his reply to Sir William Beveridge in the *Economic Journal*, December, 1923, an improvement in the term of trade without reference to the volume of trade, might be misleading. Even a worsening of the term of trade, due to, say technical progress in a country, leading to a fall in the price of exports, might, on the whole, prove advantageous to that country if the foreign demand for such exports is quite elastic.

² Vide Sir D. B. Meek's paper on "Indian External Trade" in the *Journal of the Royal Society of Arts*, June 26, 1936, where the following Table showing the index number of the volume of crop production in India, has been given:—

Average of 5 years.	All crops.	Food crops.	Other crops.
1909-10 to 1913-14	100	100	100
1927-28	109	104	133
1928-29	116	113	129
1929-30	117	115	126
1930-31	118	117	124
1931-32	112	118	87
1932-33	116	119	104
1933-34	119	121	110

In each of the above countries, there must have been a period of strain impairing the economic system, which culminated in a loss of national income.

Besides the countries mentioned above, there were others, practically embracing the whole world, which were affected by the strain and the depression. It follows therefore that world causes must have been at work. They did not however affect different countries in the same manner. Soviet Russia is probably the only important country in the world which had comparative immunity from the ravages of the great "economic blizzard". But although its industrial production had a phenomenal increase throughout the period of the depression, due to the adoption of the Five-Year Plan, it could not altogether escape from the adverse effects of the great international slump. Its exports which reached their maximum in 1930, declined in subsequent years.

Economic structure of a country.

As is well-known, the economic structure of a country to a great extent determines whether it should be more or less vulnerable to external disturbances. Thus Sweden "did not feel the depression in any real sense until late in 1930". This was partly due to the composition of its foreign trade. About 50 per cent. of its exports consisted of those raw materials and allied goods, the demand for which was more or less maintained while agricultural goods which suffered the greatest fall in prices, formed only 10 per cent. of its exports. The remaining 40 per cent. represented "finished products of importance to industry..... or high grade specialty products" holding a favoured position in the world market.¹ "Furthermore, industrial firms in Sweden often manufacture a variety of products and their plants are scattered through small communities. Also wealth and income are more evenly distributed than in larger countries." On the other hand, a country like England whose foreign trade looms large in its economic life must be more susceptible to external influence than a country like France, which, in spite of its post-war industrialization, is even now fairly self-contained in character. According to a recent Report of the Royal Institute of International Affairs,² the lateness of the impact of the depression in France is partly due to the following reasons: "French export markets are largely in Europe or in French colonies (where they have a privileged position).....Export trade has not the same relative importance as in industrial England or agricultural Denmark. Agricultural production, except vine-cultivation and in some districts, market gardening, is mainly for home production, and a large part of industrial

¹ *Index* (Stockholm) October, 1936.

² *Unemployment, An International Problem* by the Royal Institute of International Affairs, pp. 128-29.

production is for the home market." In the case of India, it has been estimated that its internal trade is at least fifteen times¹ the value of its foreign trade. It stands to reason therefore that any economic disturbance abroad, should affect our economic life far less than that of England.

On the other hand if a country develops its economic life at a rapid rate, certain maladjustments appear which upset the previous balance between rural and urban industries, between agriculture and manufacture, between exports and imports and so on. The stress becomes all the greater if this quickened pace is due to some form of state assistance such as tariffs and bounties. The U.S.A. offers a striking illustration. In spite of its foreign trade forming only a small proportion of its total trade, it was one of the worst sufferers during the depression. Apart from unsound finance and banking,² its trouble lay in "the failure of the home market to respond to the huge increases in capacity and production which took place during and after the World War." Australia is another case in point. As Copland writes in *Australia in the World Crisis*: "Manufacturing production increased from 26 per cent. of total production in 1913 to 35 per cent. in 1927-28. . . . In manufacturing the greatest increases had occurred in protected industry. . . . Obviously, development of this kind is costly and throws a heavy burden upon export industries. The Tariff Committee, appointed by the Prime Minister, reported in 1929 that the cost to the export industries was from 8 per cent. to 10 per cent. in 1926-27, and it viewed any increase with concern." Although corresponding estimates are not available for India, there is no doubt that her economic development was equally lop-sided.

External and internal factors.

It is generally found that a business cycle proceeds from one manufacturing country to another much more easily than from one agricultural country to another. In the former case, similar factors operate in all countries producing manufactures for overseas markets on competitive terms. So far as an agricultural country is concerned, its production may be affected by, say the failure of rain, a cause which may or may not operate elsewhere. In any case, with the onset of a depression manufacturing countries try to curtail their output whereas agricultural

¹ Mr. E. M. Cook of the Finance Department of the Government of India was of opinion that the internal trade of India was certainly fifteen times larger than its external trade and possibly the proportion was even higher. (*Vide* Dalal's Minority Report, Babington Smith Committee, paragraph 28). According to the *Economist* (London) "the total internal trade of India, can hardly be less than ten or twenty times the value of her external trade of about 300-400 crores annually". (*Banking Supplement*, October 12, 1935, p. 17).

² While the commercial loans of the member banks of the Federal Reserve System were not greater in 1929 than in 1921, there was a rapid increase in the volume of bank credit in its more speculative and less liquid forms during the years 1921-29.

countries cannot do so because their products have, as pointed out in Lecture II, a comparatively inelastic supply. Any contraction of output in agriculture must necessarily be slower, "since the time that elapses before a decision about future production can take effect may be anything from one year for cereal crops to three years or more for cattle and dairy products".¹ Moreover, the farmer usually hopes to get the same monetary return by increasing the output although each unit has to be sold at a lower price than before. It is therefore clear that the nature and course of depression in an agricultural country like India must be somewhat different from that in an advanced industrial country of the West.

On the other hand, it is common knowledge that in the post-war world there have been operating forces tending to make the whole world one single economic unit. For example, the rapid improvement of wireless and of transport is fast annihilating time and distance. The restoration of the gold standard in a large group of countries including India, as pointed out in the fourth lecture, means internationalism in the monetary sphere. One would therefore expect that the buoyancy of credit or its strain, would be quickly transmitted from one gold standard country to another. But such immediate repercussion of external disturbances on the economic life of a country is being impeded in the post-war world by a recrudescence of economic nationalism under the guise of tariffs, quotas and various sorts of restrictions. Even the gold standard itself is being so managed as to insulate the domestic market from external influences, unless they are strong and persistent. For example, as mentioned in the last lecture, the widening of our gold points made our domestic market less sensitive to short period disturbances in foreign markets. In spite of this, India could not escape the effects of serious economic instability in other gold and non-gold standard countries with which she had important trade relation.

Deeper causes of maladjustment.

It has been stated in the fourth lecture that by 1925, the level of production and the quantum of trade in the world exceeded the pre-war level. This progress in production and trade gathered increased momentum during the next four years. But beneath this apparent prosperity lay hidden many elements of economic instability which arose mainly out of the contradictions between the simultaneous operations of the policies of cosmopolitanism and nationalism in the economic sphere. As Prof. Condliffe rightly observes, "in the post-war decade, and particularly in the years just before 1929, world movements of capital and world currents of trade were not harmonised. . . . The payment of heavy interest obligations by the debtor countries could have been made in three

¹ *The Improvement of Commercial Relations between Nations. The Problem of Monetary Stabilization* (International Chamber of Commerce, Paris, 1936), p. 127.

ways—by increasing their exports of commodities, by exporting gold, or by contracting fresh loans.”¹ The first was made difficult by a double reason,—partly because of the imposition of tariffs by some of the creditor nations and partly because of the failure of debtor countries to reduce their prices so as to stimulate exports. Thus as early as 1927, the price level in the United Kingdom was about 42 per cent. above the pre-war level according to the Board of Trade Index Number whereas the price level in Australia was nearly 67 per cent. higher than in pre-war days. In the case of India, as measured by the Calcutta wholesale index, the price level that year was 54 per cent. up.

The second method was hardly practicable in view of the limited gold resources of the debtor countries. Thus for a time the difficulty of transfer had to be avoided by fresh loans from the creditor nations. This required that the rate of interest in debtor countries should be higher than in creditor countries. Once this inequality ceases, capital flow must also cease. From the next table (Table No. 22) it will be seen that from 1926 onwards, bond rates all the world over were going down, substantial parity being reached by the middle of 1928, after which the rates again began to diverge.

By 1928, foreign capital issues on the New York market showed a definite decline which became very pronounced next year. It is no wonder therefore that the first signs of the strain became quite perceptible in the debtor countries during the latter half of 1928.²

Strain from the beginning of 1929.

In India the economic maladjustment preceding the depression began to be felt almost from the very beginning of 1929. The signs of this strain were just the opposite of the indications of a boom. During a boom there is a disparity between prices and costs, leading to higher profits, generally by a rise of prices, costs remaining more or less steady. One important exception to this was the stock exchange boom in New York in 1928 which originated in a period of gently falling prices. The U. S. A. Bureau of Labour Index Number of Wholesale Prices which stood at 143 in 1926, dropped to 137 in 1927, rose to 140 in 1928 and fell again to 138 in 1929. As Cannan points out, “the American elation which by its breakdown towards the end of 1929 introduced a world-wide depression, was not founded on over-estimation of the probability of high prices but on an over-estimation of the demand to be expected at equal or lower prices.”³ In any case, at bottom it was the expectation of a higher profit, due to a disparity between prices and cost

¹ *World Economic Survey*, 1931-32, p. 45.

² *Ibid.*, pp. 56-57.

³ Cannan—*Modern Currency and the Regulation of its Value*, p. 109.

TABLE 22.

ACTUAL PERCENTAGE YIELDS OF BONDS.

(Data from *Statistical Year Book of the League of Nations, 1930-31.*)

	1926		1927		1928		1929	
	June.	Dec.	June.	Dec.	June.	Dec.	June.	Dec.
Argentine (Mortgage cedulas 6%).	6.28	6.26	6.14	6.12	6.01	6.01	6.01	6.19
Canada (Province of Ontario).	4.80	4.75	4.55	4.35	4.40	4.60	4.95	4.90
U.S.A. (Liberty and Treasury Bonds).	3.90	3.84	3.47	3.34	3.40	3.53	3.71	3.46
Germany (Mortgage Bank).	7.64	7.29	7.30	7.62	7.75	7.89	8.05	8.17
Belgium (Rente belge 3%).	7.17	5.39	5.20	5.11	4.52	4.67	4.54	4.49
France (Miscellaneous).	9.52	7.70	6.58	6.07	5.21	5.13	4.92	4.25
United Kingdom (2½% Consols).	4.50	4.63	4.61	4.50	4.46	4.46	4.61	4.75

which originated this boom. It will appear from Table 3 that the disparity between wholesale and cost of living indices in India began to widen as early as March, 1929 when it was 96 as compared with 99.3 in the same month a year ago. Since then the disparity became wider and this index recorded a fall of some 11 points in December, 1929 as compared with the pre-war period. It is hardly necessary to add that this disparity was brought about by the relative fall in wholesale prices as compared with the changes in the cost of living. While Calcutta wholesale index fell by 1 point in March, 1929 in comparison with the index number for the same month in 1928, the cost of living index during the same month recorded a rise of 4 points as compared with the figures for the corresponding month a year ago. In fact the cost of living index remained fairly steady up to December, 1929. The relative movements of the two indices are shown in Tables 1 and 2 in Lecture II.

It will appear from Table 1 that our wholesale index number fell gradually from 143 in March to 138 in June, 1929, but it rose again to 142 during the next month and reached 143 in August and September, 1929. This however does not mean a temporary revival. It only corroborates the well-known fact that when prices first begin to fall, merchants, being reluctant to sell at a loss, withhold their stock for some time, with the result that prices just harden a little. But this effect is

only temporary. It follows therefore that this slightly upward movement of prices reflects the strain which reached the breaking point in October, 1929.

Disparity in prices *inter se*.

A better indication of the lack of adjustment is the movement of prices *inter se*. For it is well-known that in a period of economic disturbance, all prices are not affected to the same extent, nor at the same time. Thus relative disparity among individual prices is at once an indication and a measure of economic maladjustment.

This is well illustrated by the course of price movement during the period of strain. Thus from Table 10 in Lecture III, it will appear that there was a continuous fall in the net barter term of trade from 1928-29 onwards until 1931-32, the figures being 95·5, 92·2, 89·5 and 88·6 respectively. Monthly figures were calculated by Messrs. Sen and Sinha sometime ago, on a somewhat different basis.¹ Representing the term of trade to be 100 in January, 1929, it dropped to 90 in June, that is, in 6 months' time.

A similar disparity is noticeable in the prices of raw materials and manufactured goods. The price of both these classes of goods falls, with the approach of a depression but manufacture containing less flexible elements, falls less in price than that of raw materials. This has been clearly shown in the paper on "Indian Prices During the Depression" by Messrs. Sen and Sinha.² It appears from this paper that while the disparity index of the composite price of cotton and jute manufactures on the one hand, and of the composite prices of raw cotton and jute on the other, was 100 in January, 1929, it rose to 101 in April and it reached 105 in September of the same year.

This disparity is also apparent from Table No. 23, giving the course of prices for raw cotton and cotton manufactures. The widening of the gap between the two during the period of the strain is clearly brought out in Chart No. X.

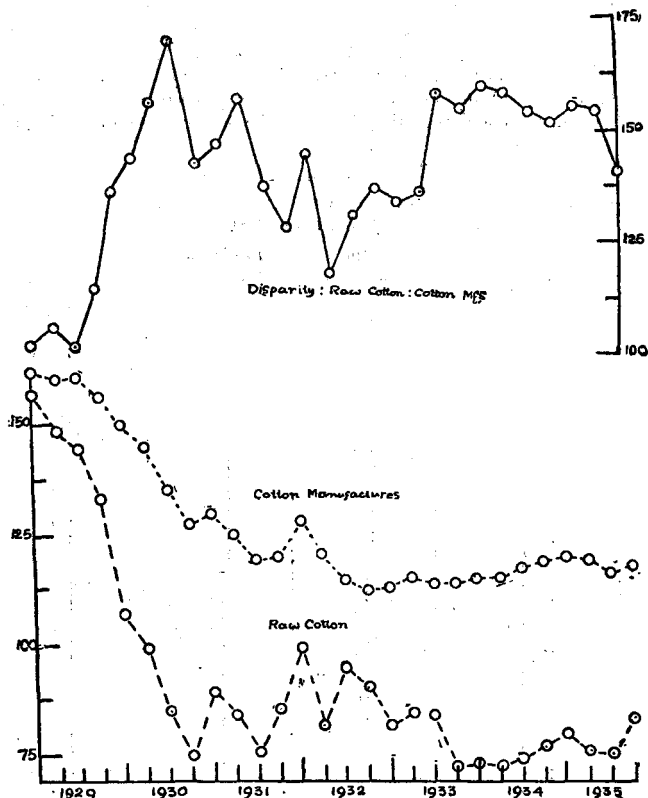
¹ See *Sankhya*, Vol. I, Part I, June 1933. We have considered here the reciprocals of their figures.

² *Sankhya*, Vol. I, Part I, June 1933.

TABLE 23.
 PRICES OF RAW COTTON AND COTTON MANUFACTURES (QUARTERLY)
 JULY, 1914=100.
 (Data from the *Indian Trade Journal*.)

	Index No. of raw cotton (1)	Index No. of cotton manu- factures. (2)	% of manufactured cotton Index to raw cotton Index No. (3)=(2) ÷ (1) X 100.
1928-II	178	159	89
III	161	161	100
IV	159	160	101
1929-I	157	162	106
II	148	160	109
III	144	161	105
IV	133	156	118
1930-I	107	149	139
II	99	145	147
III	85	135	159
IV	74	127	172
1931-I	89	129	145
II	84	125	149
III	75	119	159
IV	86	120	139
1932-I	99	128	130
II	82	120	147
III	95	114	120
IV	90	112	133
1933-I	82	113	139
II	84	114	135
III	83	113	137
IV	71	113	159
1934-I	73	114	156
II	71	114	161
III	73	116	159
IV	77	118	154
1935-I	79	119	152
II	76	118	156
III	75	115	154
IV	83	116	141
1936-I	77	114	149

CHART X.
COURSE OF PRICES OF RAW COTTON AND COTTON MANUFACTURES.



It is true that this disparity is partly due to the imposition of tariffs. To obviate this difficulty, a corresponding table (Table No. 24) has been prepared for prices of raw and manufactured jute, which is otherwise instructive, for it reveals a weakness in our economic system in spite of the fact that we have a monopoly of this product. Chart XI indicates the growing disparity between the prices of raw and manufactured jute which reached its maximum during the second and third quarters of 1934.

We have discussed so far quarterly figures for raw and manufactured cotton on the one hand and raw and manufactured jute on the other. But it has been thought advisable to describe them in greater detail, month by month, during the period of strain and crisis and also some months before and after. This has been done in Table No. 25. The great hardship caused to our agriculturists is quite apparent from the table. It will also be seen to what extent protection has acted as an economic friction preventing the fall in the price of cotton manufactures along with raw cotton prices.

TABLE 24.
PRICES OF RAW JUTE AND JUTE MANUFACTURES (QUARTERLY)
JULY, 1914=100.
(Data from the *Indian Trade Journal*.)

Year.	Index No. of Raw Jute. (1)	Index No. of Jute Manufacture. (2)	% of Manufactured Jute to Raw Jute (3) = (2) ÷ (1) × 100.
1927-I	92	141	154
II	88	138	156
III	105	156	149
IV	88	148	167
1928-I	91	144	159
II	104	153	147
III	106	159	149
IV	99	147	149
1929-I	107	139	130
II	95	123	130
III	95	125	132
IV	83	104	125
1930-I	78	94	120
II	75	95	127
III	55	90	164
IV	45	74	164
1931-I	44	81	182
II	47	73	154
III	47	67	143
IV	60	83	137
1932-I	51	80	156
II	42	70	167
III	47	78	167
IV	41	74	179
1933-I	38	69	182
II	47	83	175
III	42	81	185
IV	37	73	196
1934-I	42	80	189
II	38	76	200
III	37	75	200
IV	41	76	185
1935-I	46	79	172
II	51	77	149
III	48	71	149
IV	54	70	130
1936-I	54	66	122

CHART XI.

COURSE OF PRICES OF RAW AND MANUFACTURED JUTE.

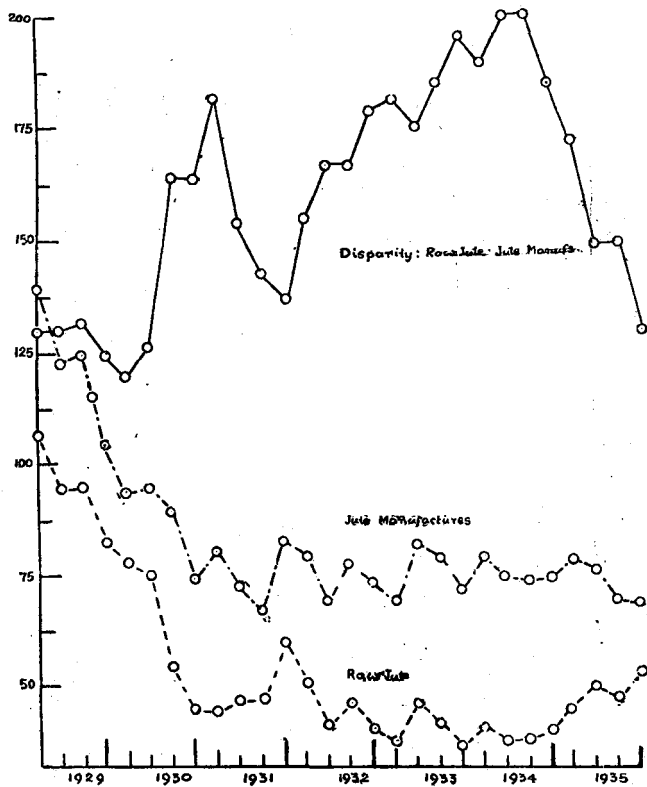


TABLE 25.

PRICES OF (a) RAW COTTON AND COTTON MANUFACTURES; AND
(b) RAW JUTE AND JUTE MANUFACTURES (MONTHLY FIGURES)

JULY, 1914=100.

(Data from the *Indian Trade Journal*.)

Year.	Month.	Index No. of Raw Cotton.	Index No. of Cotton Manu- factures.	Index No. of Raw Jute.	Index No of Jute Manu- factures.
1928	April.	173	157	101	152
	May.	179	159	102	149
	June.	182	161	108	157
	July.	180	162	112	166
	August.	154	161	111	166
	September.	149	161	95	145
	October.	159	161	99	145
	November.	159	160	100	148
	December.	159	160	97	147
1929	January.	153	163	107	139
	February.	158	162	108	138
	March.	161	161	106	139
	April.	152	161	97	125
	May.	148	160	95	124
	June.	144	160	94	120
	July.	141	160	95	122
	August.	146	162	99	130
	September.	146	161	90	122
	October.	139	158	85	104
	November.	133	157	81	104
	December.	128	153	84	103
1930	January.	112	150	84	97
	February.	101	147	79	97
	March.	107	149	72	89

Rise in the interest rate.

It has been pointed out above that the depression had set in Java and Australia long before it began elsewhere. The demand for jute bags considerably fell off in these two important markets with the result that the price of jute manufactures was falling very rapidly—indeed at a more rapid date than that of raw jute which was also declining, showing that in certain cases even manufactured goods may record a steeper decline than agricultural products. We find also that the price of 3½ per cent. Government paper which is a fairly good index of our long-term rate of interest, began to fall definitely from March, 1929, as will be evident from Table 5. Conditions in the short term market were also more tight throughout the year 1928-29 as compared with 1927-28 which itself was a year of stringency, relatively to the easy money conditions prevailing during the greater part of the year 1926-27. Thus the financial year 1928-29 opened with 7 per cent. bank rate. It drop-

ped to 6 per cent. on the 21st of June and to 5 per cent. on the 19th of July. The rate was later on raised to 6 per cent. on the 15th of November and to 7 per cent. on the 13th of December, 1928. On the 14th of February, 1929, there was a further rise to 8 per cent. which rate remained in force till the second week of April next,—a rate not reached any time after May, 1924. This rise in both short and long term rates of interest reflects strain on our economic system during the closing months of the financial year 1928-29.

Internal trade movement.

Another indication is provided by the volume of remittance of funds through the Imperial Bank of India. This is a fairly reliable index of the activity in internal trade. It appears from Table No. 18 in Lecture V that the demand drafts purchased in the Bengal Circle during the first half of the calendar year 1929, was Rs. 7 crores less than during the same period in 1928. The drafts purchased in Bombay and Madras Circles during January to June, 1929 were however slightly larger in value than during the same months of the previous year. This shows that the strain in Bengal began earlier than in Bombay or Madras. An obvious explanation of this lies in the fact that the problem of Bengal is mainly the problem of jute. The fall in jute prices brought about an economic maladjustment in Bengal much earlier than in other parts of India.

Fall in the exchange rate.

The question now is, how did this strain affect our monetary system? As the strain was due to adverse external situation, one of its earliest effects was on the exchange rate. It was consistently above parity and rose to 1s. 6 1/16d. in November, 1928, but by January next, the rise in the short term rates of interest abroad which has already been referred to, had a weakening effect on our exchange. In fact, during the nine months from January to September, 1929, the rate of exchange remained lower than during the corresponding months of the previous year, as will be evident from the Table No. 26 given on the next page.

Was devaluation desirable?

This continuous sag in exchange led to a cry for lowering the exchange rate to 1s. 4d. (gold). In his Budget speech on February, 28, 1929, the Hon'ble Sir George Schuster opposed this demand. According to him, there could hardly be a more disastrous policy. "It would", he said, "cause injustice to thousands of individuals who had entered into previous contracts, among whom perhaps the most important are the workers, manual or otherwise, whose wages and pay have been fixed on a different basis, and it would strike a blow at the credit of

India in the eyes of the world from which it could hardly recover. For, what guarantee would other countries have that a word once broken, would not be broken again?"

In fairness to his critics, it must be pointed out that Sir George's defence was rather a weak one. To his argument that wage-earners

TABLE 26.

HIGHEST AND LOWEST QUOTATIONS FOR TELEGRAPHIC TRANSFERS ON LONDON FOR EACH MONTH.

(Data from *Report of the Controller of Currency for India.*)

	Highest.	Lowest.		Highest.	Lowest.
1927-Nov.	1-6	1-5½	1928-Nov.	1-6½	1-6½
Dec.	1-6½	1-6	Dec.	1-6½	1-6½
1928-Jan.	1-6½	1-6½	1929-Jan.	1-6½	1-6
Feb.	1-6½	1-5½	Feb.	1-6	1-5½
Mar.	1-5½	1-5½	Mar.	1-5½	1-5½
Apr.	1-5½	1-5½	Apr.	1-5½	1-5½
May.	1-5½	1-5½	May.	1-5½	1-5½
June.	1-5½	1-5½	June.	1-5½	1-5½
July.	1-5½	1-5½	July.	1-5½	1-5½
Aug.	1-5½ ¹	1-5½	Aug.	1-5½	1-5½
Sept.	1-6	1-5½	Sept.	1-5½	1-5½
Oct.	1-6½	1-6			

and the salaried class, would suffer, it might be said that they formed only a small percentage of the total population. If the policy of devaluation was really in the interest of the majority of our people, this hardship to a small minority, could be ignored. Sir George's second argument that devaluation would be regarded as a sign of national bankruptcy, though substantially true at the beginning of 1929, was hardly true even by the end of that year when the sanctity of gold par was violated by several countries which were already in the throes of the depression. In view of devaluation by countries like U.S.A., Czechoslovakia, Belgium and France, it is now difficult to maintain the argument that once a country has adopted a certain parity in terms of gold, it must

¹ In the Controller of Currency's Report for 1928-29, p. 38, the highest rate for August quoted, is 1s.—5 21/32. This is obviously a misprint for 1s.—5 29/32.

defend it at all cost. In fact, the suspension of the gold standard by the United Kingdom without fixing any parity at all, not even a lower parity, shows that devaluation need not be looked upon with horror.

On the other hand, the arguments advanced by the critics of Government were no more convincing. The contention that 1s. 4d. rate was the natural rate for India—an argument which was advanced by Sir Purshotamdas Thakurdas in his Minute of Dissent to the Hilton Young Commission and which has been repeated so often by subsequent champions of 1s. 4d. rate, can hardly be substantiated. The natural rate for the rupee is as specious as the “natural right of man”. If by ‘natural rate’ is meant the rate of exchange which would be attained under the ‘automatic’ working of the currency system, then that rate could nowhere be found in the post-war world. In fact it hardly existed even in pre-war days. The other argument that 1s. 6d. rate was not a natural rate because it had been attained by a policy of deflation, is, as we have seen in the last lecture, substantially true, but that cannot carry us anywhere. The main point at issue in February, 1929, was not how 1s. 6d. (gold) rate was brought about, but whether there was on the whole an adjustment of prices and costs in India to that rate. On this moot point, neither Government spokesmen nor their critics throw any light. Sir George Schuster had no doubt said that devaluation really meant inflation and depreciation of currency but he did not make it clear whether this would lead to such a great increase in prices as to raise the level of price above the cost of production within India, and to upset our trade relations and balance of payments with other countries which alone could be described as inflation.

The only definite statement made by him was that he was opposed to the policy of exchange depreciation for stimulating trade. Whether this policy ought to have been followed by us, especially after the suspension of the gold standard by England in September, 1931, would be discussed in a subsequent lecture. Here it is sufficient to sum up the currency policy of Government during the period of the strain, by saying that it was to fight to the last ditch for the maintenance of 18 penny gold rate.

Economic disturbances abroad.

The consequences were serious and aggravated by a series of financial disturbances abroad. In the spring of 1928, the Federal Reserve System in the U.S.A. entered upon a policy of credit restriction, with a view to check speculation on the New York Stock Exchange. By three successive stages in 1928, the discount rate of the Federal Reserve Bank of New York was raised from $3\frac{1}{2}$ per cent. to which it had been reduced in August, 1927 to 5 per cent. in July, 1928. By this measure, by open market operation and by moral pressure, the supply of call-money from

New York banks was successfully cut off. But the effect was to raise the level of call-money rates to a figure, which made investments in such funds highly attractive. This, in its turn, reduced foreign lending by the U.S.A., which necessarily, one may say, almost inevitably, led to an increase in the import of gold to the U.S.A. Between June 23, 1928 and January 11, 1929, the gold stock of the U.S.A. rose by 7 million (old) dollars, which was not allowed to affect the price level in any way.

On this policy of credit restriction in the U.S.A., were superimposed the changes in French monetary policy. By the law of August 7, 1926, the Bank of France was permitted to buy foreign exchange and to issue notes against such assets. This was reversed by the law of June, 1928. This Act as well as the punitive tax on the export of capital from France, were mainly responsible for the accumulation of gold in that country. By the end of December, 1928, the total stock of gold of central banks and governments in the world excluding Russia, was 9,918 million, (old) dollars. Out of it 1,254 million, (old) dollars was held by the Bank of France and 3,746 million, (old) dollars by the Treasury and Federal Reserve Banks of the U.S.A. As compared with her holding on December 31, 1924, France had increased her stock of gold by 544 million, (old) dollars while the U.S.A. had reduced her stock by 344 million, (old) dollars. But from the beginning of 1929, the gold holdings of both France and the U.S.A. rose steeply, while those of the rest of the world fell at an equally sharp rate. They were obliged to take steps to prevent further drain of gold. It is no wonder therefore that the Bank of England raised its rate of discount from $4\frac{1}{2}$ per cent. to $5\frac{1}{2}$ per cent. on February 7, 1929, and further raised it to $6\frac{1}{2}$ per cent. on September 26 next. In consequence of this increase in the Bank of England rate, the rate at which the Government of India was prepared to lend emergency currency was raised to 8 per cent.¹ thereby causing the Bank Rate to rise to the same level in February, 1929, as has been mentioned already.

Was there undue contraction of currency?

There was naturally an outcry from the business community that Government was starving the commercial world of its needs for currency. But in his Budget Speech on February 28, 1930, Sir George Schuster defended this policy on the ground that the contraction of currency was neither severe nor unjustified. According to him, since the beginning of the busy season from the 1st December, 1928 to the 30th November, 1929, the net contraction of currency was only 15·89 crores. Even for this small contraction he found justification in the return of rupees from

¹ The rules of September, 1924, prescribing the rate 6 per cent. for the first Rs. 4 crores of emergency currency and 7 per cent. for the remaining 8 crores, as mentioned in Lecture V had evidently been changed later on.

circulation, oblivious of the fact that this clearly showed that the strain must have been operative from an earlier date. In other words, he was talking in terms of cures whereas his critics were thinking in terms of prevention.

Sir George Schuster further alluded to the percentage of cash to liabilities of the Imperial Bank, which, according to him, was the real index of the adequacy of currency and pointed out that this percentage was higher in February, 1930, than it was at the time a year ago. The relevant figures are given in the Table (No. 27) below, for a number of years. It is quite evident that the figure for February, 1929 was not a normal one at all and quite unsuitable for purposes of comparison. In fact, it was lower than the corresponding figures during 1927, 1928, 1933, 1934 and 1935. It was only somewhat higher than the figures during the years of acute depression, *viz.*, 1931 and 1932. In any case, the comparison of any year with any other year, by placing the figures for the same month in the two years side by side is invalid. For, the monsoon does not break in exactly on the same date every year, and the busy season in consequence is sometimes early and sometimes late. It will appear from the table (No. 27) that the months of minimum percentages were as shown below :—

1927 February, April|May, December.

1928 April, December.

1929 February|March, December.

1930 May, December.

1931 February, September,¹ December.

1932 January, December.

1933 January, December.

1934 February|March, December.

¹ This was abnormal. It was due to the financial crisis leading to the suspension of the gold standard by England.

TABLE 27.

PERCENTAGE OF CASH TO LIABILITIES OF THE IMPERIAL BANK OF INDIA.
(Data from *Annual Reports of the Controller of the Currency for India.*)

	April.	May.	June.	July.	August.	September.	October.	November.	December.	January.	February.	March.
1926-27	28.9	37.0	39.6	50.7	53.1	49.6	45.6	41.8	25.4	20.6	18.4	20.3
1927-28	18.5	18.4	23.4	37.5	37.6	35.6	34.2	30.3	12.9	15.8	16.5	13.6
1928-29	11.3	13.3	17.5	28.4	29.2	29.5	23.4	17.9	12.9	15.0	13.7	13.5
1929-30	15.9	23.3	32.4	36.3	37.0	33.8	34.6	28.3	19.1	18.8	20.8	21.0
1930-31	18.0	16.3	19.9	24.0	29.2	28.3	28.7	24.6	14.5	14.4	11.6	16.0
1931-32	17.9	18.7	20.8	25.0	25.2	8.4	15.7	13.9	10.9	12.5	13.4	13.3
1932-33	15.2	19.4	24.4	35.5	35.8	35.8	35.6	33.6	27.2	24.8	28.9	31.4
1933-34	28.5	25.3	26.2	33.1	32.7	29.9	27.9	29.0	22.5	20.9	14.5	14.5
1934-35	17.3	19.9	26.2	31.9	35.3	33.7	31.9	33.3	24.2	21.8	18.6	25.2

So far as December percentages are concerned, it is usual for banks in India and elsewhere to deposit all available surplus money with the central bank of the country at about this time in order that their annual balance-sheets may show a comfortable and satisfactory figure of "Cash with Bankers". This "window dressing" resulted in a considerable increase in the deposit liability of the Imperial Bank of India and a corresponding fall in the percentage ratio. If we leave this factor out, it will be seen how irregularly the financial statistics fluctuate in India.

Were the signs of depression disguised?

It may be argued that it is because of this irregularity that Sir George Schuster failed to detect signs of strain during the early months of 1929. But were the signs so latent as that? It is true that the conditions in 1928 were not very abnormal. It is equally true that although the Imperial Bank rate was raised to 6 per cent. on November 15 and to 7 per cent. on December 13 and emergency currency to the extent of Rs. 7 crores had to be issued by December, they did not necessarily pre-
 sage danger, for they are unhappily normal features of an Indian busy season. But this complacency lasted too long. Since the beginning of the year 1929, various abnormal features appeared, mainly outside India, as has already been mentioned. It should also be pointed out that the seasonal stringency in the early months of 1929 was not so acute as it

otherwise could have been, because of the serious damage caused by frost to Broach cotton and wheat which called for correspondingly less volume of funds for financing the export bills. On the other hand, the early appearance of the cotton crop meant an early advent of the busy season (February|March in that year as compared with April|May during 1927, 1928 and 1930), requiring crop-moving funds sooner than usual, which more than compensated the ease in the money market referred to above, buttressing up the exchange rate and enabling Government to fulfil their remittance programme.

Was Government blind?

In view of all this, it is somewhat surprising to notice the complacent attitude of Sir George Schuster who in his budget speech on February 28, 1929, lightly referred to "bad patches" in the financial year which was then just closing and assured the House that there was no "ground for serious pessimism". But in fairness to Sir George, it may be asked—Was not the business world of the West, in spite of all its indices of business forecasting, really taken unawares by the great depression which broke out after the collapse of the stock exchange boom in New York? Possibly the widely prevalent belief that a boom could occur only in an era of rising prices, was responsible for the unpreparedness of the world for the greatest financial debacle. But how can one explain away Sir George's repetition of this assurance in his next budget speech in February, 1930 when the depression had already set in? The fact is, he did not realise the significance of economic events both in India and abroad sufficiently early, to take necessary steps of currency management and control.

Monetary and financial measures adopted by Government.

We have seen above that Government was not prepared to raise prices by a policy of exchange depreciation and thus to reduce the growing disparity between prices and costs during the period of strain. On the other hand, it practically refrained from imposing extra taxation in 1929-30. This had the beneficial result of not raising costs still further so as to aggravate the difficulties of the strain. The only case of new taxation during the year was the small increase in the import duty and excise duty on petrol from 4 to 6 annas per gallon. But as the additional revenue realised from this source was spent on road development, such taxation hardly increased the intensity of the strain.

Though the monetary and financial measures adopted by Government were by no means wide and comprehensive, they have nevertheless a few lessons for us. They illustrate very clearly the need for transferring the purely banking functions from the hands of Government to that of a semi-independent central bank.

As Sir George Schuster points out, "the Government are not only the currency authority but are themselves the chief operators in the remittance market. When there are difficulties as regards exchange. . . and when we take action. . . it is represented here as artificial manipulation of exchange by Government in order to meet their own remittance needs. That appearance induces an unduly hostile type of criticism."¹ Thus with the rise of the bank rate to 8 per cent. in February, 1929, there was a chorus of disapproval from the business community. This however is by no means peculiar to India. As Hawtrey points out, "Experience shows that whenever an expansion of credit is developing to excess, a formidable opposition arises in the trading world to an increase in bank rate. When on the other hand, business is in a state of depression, no one minds what happens to bank rate. The influence of outside pressure is, therefore, just the contrary to what is required".² If however the initiative for a rise in the bank rate comes not from the Government nor from a State-owned bank but from a semi-independent central bank, it can very well follow the advice "Never explain, never regret, never apologize".³

¹ *Budget of the Government of India for 1930-31*, p. 31.

² Hawtrey—*Trade and Credit*, Chapter I, p. 17.

³ The Riksbank of Sweden however shows that even a publicly owned central bank which is under the direct control of the Government and the Legislature and which makes a definite announcement of its programme of work, may, under certain circumstances, meet with a more conspicuous success in its monetary control and management than what has so far been attained by semi-independent central banks which do not disclose their policy to the public.

LECTURE VII.

COURSE AND PHASES OF THE DEPRESSION.

- I. October, 1929 to June, 1930 (9 months).
- II. July, 1930 to August, 1931 (14 months).
- III. September, 1931 to December, 1932 (16 months).

In the last lecture it was pointed out that depression in the sense of diminishing real income commenced in some countries as early as 1927 whereas it was deferred until the middle of 1930 in the case of others. In spite of this, it is usual to date the beginning of the depression from the collapse of the Stock Exchange boom in New York in October, 1929. Two of the most sensitive indices of economic activity, *vis.*, wholesale prices and volume of foreign trade recorded decline from the early autumn of 1929. On the other hand, index number of production in different countries showed less regularity. It appears from Ohlin's *Course and Phases of the World Economic Depression*¹ that the recession in output began on the following dates in different countries.

Country.	Year.	Quarter.
Germany	1929	IV
Canada	1929	III
U.S.A.	1929	III
France	1930	III
United Kingdom	1930	I

Prices of industrial shares which are highly correlated with profits and provide very sensitive indices show greater irregularity. But the Stock Exchange collapse in New York affected share values in all countries, although not to the same extent nor in the same manner. In Germany it intensified the decline which had started in 1928. In the case of the United States and to a less extent in France, there were temporary revivals in the early months of 1930. It is only in the case of the United Kingdom that there was an uninterrupted decline.

First phase of the depression.

In spite of these divergences, it is possible to divide the whole course of world depression into a number of broad phases,² the first

¹ Ohlin—*The Course and Phases of the World Economic Depression* (revised edition, Geneva, 1931), Table V, p. 140.

² It will be seen that a departure has been made here from Ohlin for facility of discussion.

extending roughly from October, 1929 to June, 1930, the characteristic feature of which was its heavy incidence specially in countries producing raw materials and foodstuffs. It was pointed out in the previous lecture that during the period of the strain, prices of agricultural goods began to fall more steeply than those of manufactured goods, in spite of valorisation schemes etc., and other devices already mentioned. In the next place it has to be remembered that, generally speaking, these are debtor countries, and the real burden of their debts was considerably increased. To meet these onerous foreign obligations, and to maintain the external value of national currencies, high short-term and long-term rates of interest and similar devices had to be resorted to, intensifying the fall in the price level still further. Even that did not make the cup of misery quite full. For such serious decline in prices was sought to be remedied by increased output so as to maintain the same income, with the result that there was an enormous addition to the available supply for overseas markets, which were however restricting access to these commodities by strong measures such as tariffs and quotas. The vicious circle was quite complete and it is no wonder that agricultural countries were the worst sufferers.

On the other hand, manufacturing countries, specially those which were creditor countries, were not so much affected till the close of the first phase of the depression. The only important exception was the U.S.A. whose special difficulties have already been referred to, in the last lecture. But even in her case there was a temporary revival of industrial production at the beginning of 1930. When the first shock in the creditor countries of New York Stock Exchange collapse was over, the flow of capital to debtor countries revived. The export of capital to the latter which had dropped to \$1,236.4 millions in 1929, rose to \$1,655.7 millions in 1930.¹ This temporary revival of foreign lending, though much below the volume attained in 1927, sustained to some extent, the buying power of debtor and agricultural countries for manufactured goods and brought about a corresponding improvement in the economic condition of manufacturing countries. The downward trend of industrial production was slowed down in many cases, stopped in some cases, and reversed in the case of a few.

Second phase of the depression.

During the second phase from July, 1930 to August, 1931, manufacturing countries also became depressed. There was a deepening of the depression in the countries already suffering, whereas some other countries not yet seriously affected, such as France and Scandinavian countries, began to feel the effect of the depression. We have seen that during the previous phase agricultural and debtor countries could carry

¹ *Unemployment, An International Problem*, p. 97.

on only by applying drastic methods, which by their very nature could not be expected to yield permanently beneficial results. On the other hand during that period the condition of manufacturing countries was rapidly deteriorating although all the features were not apparent on the surface. The demand for manufactures, the income from foreign investments, the exchange rate with such agricultural and debtor countries,—all these were maintained by easy credit and free lending on the part of manufacturing countries. On the top of this, the catastrophic fall in agricultural prices was tending to bring down manufacturing prices throughout the first phase of the depression and this pressure could not be withstood any longer.

The following table (Table No. 28) gives the index number of wholesale prices for a number of countries, including India. A column is added to the table showing the index number of gold prices calculated upon the same base. These index numbers are not strictly speaking comparable. They are neither compiled in the same manner nor do they consist of the same items of commodities yet they broadly indicate the course and phases of the depression in different countries.

TABLE 28.

INDEX NUMBERS OF WHOLESALE PRICES IN VARIOUS COUNTRIES.

MARCH, 1929 TO MARCH, 1934.

(BASE: MARCH, 1929=100.)

[Source: *World Economic Survey*, 1933-34 (Geneva), p. 139.]

Country.	Index Numbers. National Currency.					Gold Prices.
	March, 1930.	March, 1931.	March, 1932.	March, 1933.	March, 1934.	March, 1937
India	87.4	69.9	65.7	57.3	61.5	38.5
Czechoslovakia	87.0	79.4	72.3	68.0	69.6	69.6
Germany.	90.5	81.6	71.5	65.3	68.7	68.7
Austria.	91.0	80.5	85.0	80.5	85.0	65.8
Switzerland.	92.4	80.1	69.6	63.5	64.1	64.1
France.	85.5	82.5	68.0	59.7	60.3	60.3
Poland.	88.9	77.8	68.9	60.6	58.1	58.1
Belgium.	89.1	75.9	63.1	58.0	55.0	55.0
Italy.	87.4	71.3	64.5	57.5	55.1	53.5
Netherlands.	83.5	70.1	54.9	48.2	53.0	53.0
China.	106.9	121.1	112.1	102.9	92.8	46.8
Yugoslavia.	85.5	70.0	63.6	62.9	59.4	45.5
Sweden.	86.8	78.5	75.7	72.9	77.8	45.4
Netherlands Indies.	92.7	74.0	60.7	48.0	45.3	45.3
New Zealand.	99.8	92.6	89.5	88.9	90.5	45.1
Canada.	96.0	77.9	72.2	67.4	75.3	44.7
Australia.	91.9	81.3	80.2	74.4	81.4	40.4
Argentina.	97.4	88.8	94.0	86.4	97.4	34.8
United States.	93.9	79.1	68.7	62.6	76.7	31.3
Japan.	86.6	70.0	70.1	78.4	78.2	28.0
United Kingdom.	88.7	75.6	74.6	69.6	74.0	27.6

Deepening of the crisis.

As prices tended to go down or went down in manufacturing countries, their trade languished. The demand for money for trade purposes fell for a double reason, firstly because trade was less than before and secondly because prices were lower. Production was equally affected and there was less need for industrial circulation. Stock markets were stagnant, which again called for less money. There was less of business confidence requiring bankers to proceed with caution when loans had to be issued. It is no wonder therefore that there was a large reduction in bank rates in most of the manufacturing and creditor countries. The Bank of England rate which had been reduced to 3 per cent. on May, 1930 towards the close of the first phase of the depression was further reduced to $2\frac{1}{2}$ per cent. on May 1, 1931, the lowest rate reached after the war. On May 1, 1930 the Bank of France rate had been reduced to $2\frac{1}{2}$ per cent. It was further reduced to 2 per cent. on January 2, 1931. The New York Federal Reserve Bank rate was lowered to 2 per cent. in December, 1930 and further lowered to $1\frac{1}{2}$ per cent. in May, 1931. Such easy money conditions hid great economic maladjustment in those countries. Nor could this ease pass to agricultural and debtor countries.

In fact portents were not wanting that the situation was not free from anxiety. As rightly pointed out in the *Report of the Controller of the Currency* for 1930-31, "two events of the year which had repercussions on world finance may be mentioned briefly, namely, the large number of bank suspensions in the United States and the so-called Oustric collapse in France, both of which contributed in no small degree to retard a return of confidence". Political troubles aggravated the difficulties of the South American republics. China, though happily freer from internal strife, was grievously affected by the catastrophic fall in silver prices. The only redeeming feature during the year was the setting up of the Bank for International Settlements on May 17, 1930, which could not, however, secure economic adjustment and stability just as the League of Nations has failed to create political compromise and concord.

We have referred above to the difficulties of agricultural debtor countries. The burden of debt was also heavy in the case of other debtor countries, even though they were not predominantly agricultural. With the fall in the price of manufactures, the real burden of indebtedness was aggravated. On both Germany and Austria, it was almost unbearable. In May, 1931, the collapse of Kreditanstalt in Austria showed clearly how dangerous the situation was. Germany was in almost a desperate condition. On June, 20, 1931, the U.S.A. Government declared one year's moratorium to inter-government debts. The Bank for International Settlements and the central banking institutions of the U.S.A., England and France granted a rediscount facility of one

hundred million dollars to the Reichsbank. These proved unavailing. The financial chaos could not be set right even by such generous measures.

For it culminated in the tragedy of the pound. Not that the Bank of England did not take early steps. From $2\frac{1}{2}$ per cent., the Bank rate was raised to $3\frac{1}{2}$ per cent. on July 23 and to $4\frac{1}{2}$ per cent. on July 30. Large credits were procured from France and the U.S.A. to compensate for the outflow of gold. Emergency budget with drastic taxation and severe retrenchment, was passed. These failed to achieve their purpose. England was obliged to abandon the gold standard on September 21, 1931. Her example was quickly followed by many other countries. "Before the end of October, all the British Dominions excepting South Africa,¹ the rest of the British Empire and the three Scandinavian countries, as well as Portugal, Egypt, Bolivia and Finland had departed from gold. Japan followed in December 1931, Greece in April 1932, Siam and Peru in May 1932".² The wheel was almost completely reversed from the position of 1925-26. Fate enjoyed her inscrutable smile.

The third phase.

But we are anticipating events. With the breakdown of the gold standard, was ushered in the third phase of the depression which lasted from September, 1931 to December, 1932. During this period, as pointed out in the *World Economic Survey* (1932-33), "trade restrictions, declining trade, distorted balances of payments, frozen debts and exchange instability reacted unfavourably one upon another". Even this list is not quite complete. Political unrest prevailed in many countries, partly due to growing unemployment and partly due to the severity of the measures of taxation and retrenchment which had to be adopted for the balancing of budgets and for meeting external obligations. The failure of the Disarmaments Conference and of the settlement of war debts, the increased tension between China and Japan and similar other factors aggravated the difficulties. In spite of this, it must be recognised that the rate of deterioration in the economic condition was somewhat slowed down after September, 1931. For throughout the last phase, there was a growing recognition of the necessity for raising prices if necessary in an international way. Cheap money prevailed in most countries. There was a considerable increase in bank deposits everywhere. What was more gratifying was that there was an appreciable fall in the long-term rate of interest, enabling the Governments of several countries to fund or convert their debts on easier terms, thus relieving their financial situation to some extent.

¹ South Africa went off the gold standard in December, 1932 when her currency was pegged to British sterling.

² *Final Report of the Gold Delegation of the Financial Committee of the League of Nations* (Geneva, 1932), p. 9.

The improvement in the money market may be inferred from a comparison of bank rates in different countries during the second and third phases of the depression. Thus in England the Bank rate was raised to 6 per cent. on September 21, 1931, and reduced to 5, 4, $3\frac{1}{2}$, 3, $2\frac{1}{2}$ and 2 per cent. respectively on February 18, March 10, March 17, April 21, May 12 and June 30, 1932. This low rate of 2 per cent. was continued not only during the last half of 1932 but also in subsequent years. Similarly low short-term rates ruled in other countries. It must be remembered, however, that this great ease was partly due to the need for less industrial and financial circulation, and was to that extent an unhealthy sign. Similarly, the low long-term rate of interest mentioned above, was partly brought about by a reduction of capital needs, showing absence of business confidence. At the same time, there is no doubt that cheap money was removing obstacles on the road to recovery and making it possible for recovery to proceed when and where conditions were otherwise favourable.

How was India affected?

We have hitherto considered the three phases of the depression as prevailing in the different countries of the world. It now remains for us to examine their repercussions on Indian economic life. Agriculture which gives occupation to the vast majority of our population, became more depressed with the onset of the depression abroad. Some provinces where the production of commercial crops is of preponderating importance, suffered more acutely than others. The sad plight of Bengal has already been referred to. This was partly aggravated by the special features of jute already mentioned, but the areas growing cotton, or groundnut, and wheat for export were also very adversely affected. Production was not curtailed. Some of the crops were then on the fields. Nor even could they be restricted during the next sowing season, for what other sources of income were open to our cultivators? The output of crops cannot therefore provide a dependable index of agricultural crisis, which has therefore to be studied in an indirect manner.

Overdue loans of agricultural societies, an index of depression.

One such measure is the proportion of overdue loans in co-operative agricultural societies, a detailed statement of which is given in Table No. 29, showing roughly the incidence of the depression in rural areas of different parts of India. It will be seen that the percentages remained fairly steady during 1927-28 and 1928-29, although there were wide variations from province to province, Punjab and Burma recording the lowest percentages, the United Provinces and Assam about the highest percentages. It will be seen that in all areas, the percentages rose very

sharply during 1929-30, 1930-31 and 1931-32, somewhat less steeply during 1932-33, when there was noticed steadiness in some cases. In most cases there is an improvement in 1933-34 as compared with 1932-33, which has been maintained. In Bengal the deterioration in the economic condition began as early as 1927-28, since when there is a steady increase in the proportion of overdue loans. In Bombay, however, the proportion remained steady up to 1930-31, after which there is recorded a rise, but not at a very fast rate. This great difference between a predominantly agricultural province growing a commercial crop and a manufacturing province enjoying protection is noticeable and shows clearly that during the first phase of the depression, manufactures were not as much affected as agriculture.

TABLE 29.

PROPORTION¹ OF OVERDUE LOANS TO TOTAL LOANS DUE BY INDIVIDUALS TO AGRICULTURAL PRIMARY SOCIETIES.

	Madras.	Bombay.	Bengal.	Bihar & Orissa.	United Provinces.	Punjab.	Burma.	C. P. & Berar.	Assam.	Other Provinces in Br. India.	Total for British India.*	Total for Indian States.*	Grand Total.*
	%	%	%	%	%	%	%	%	%	%	%	%	%
Year.													
1927-28	27	34	29	12	43	6	5	31	34	14	20.8	21	20.8
1928-29	27	31	34	12	38	6	7	35	41	7	21.3	22	21.5
Average for 1927-29	27	32.5	31.5	12	40.5	6	6	33	37.5	10.5	21.8	21.5	21
1929-30	30	31	40	17	47	8	7	46	50	6	24.8	24	24.5
1930-31	45	30	56	22	65	8	13	58	64	9	32.6	30	32.3
1931-32	55	44	68	43	70.5	7	12	68	72	9	40.9	34	40.1
1932-33	59	49	81	58	68	6	38	74	88	9	46.3	48	46.6
1933-34	60	47	80	71	66	5	58	80	95	6	47.4	54	48.5
1934-35	54	48	74	81	59	5	65	79	95	5	45.8	38	44.9

* These figures are not the averages of the percentages recorded here. They are derived from the totals of the original data for loans and overdues.

¹ The percentages in this table, have been calculated from the figures for

To facilitate the description of the depression, some indices of economic fluctuations have been extracted from *Monthly Survey of Business Conditions in India* and have been reproduced in Table No. 31. It is recognised that there are several difficulties in this procedure. Firstly, some of the necessary data are available only after the beginning of the period of recovery. If earlier data are extracted from other sources, they cannot be easily reduced to a comparable form. In the second place, monthly figures which alone can furnish materials for a description of short-term fluctuation are subject to large seasonal changes in India. Data for a sufficient number of normal years have not yet been accumulated to permit adjustments for seasonal changes on a proper statistical basis. There are other difficulties also, which will be enumerated when the particular series are described.

Net ton-miles in railway transport.

Trade figures merit the first consideration in our hands. For trade statistics, figures of tonnage entered and cleared both for foreign and coastal trade and of railway wagons loaded and gross railway earnings for inland trade would have been exceedingly useful. Unfortunately the necessary data are available from the *Monthly Survey* only for a later period. Of still greater use would have been the index numbers of declared values of exports and imports and their derivative index for the net barter term of trade, which could have revealed the underlying economic conditions governing trade. But these data also have not been published in the *Survey*. The only figures available are annual net ton-mileage data of Class I Railways which are reproduced from the *Review of the Trade of India*, in Table No. 30. The serious decline during 1933-34 and the subsequent recovery are noticeable. But the course and phase of the depression cannot be studied in detail on the basis of these data. Apart from this, on account of the imposition of protective duties, long leads from ports to remote mofussil areas and *vice versa* have been replaced by short hauls from fields to adjoining factories and back, with the result that there has been a diminution in net ton-mileage.

It has therefore been thought advisable to consider indirect measures of trade activity, with the help of statistics of production and finance. During the three phases of the depression, the trends were more pronounced than seasonal fluctuations. The intermediate figures have

the amount of loans and overdues, given in (annual) *Statistical Statements Relating to the Co-operative Movement in India* (published by the Government of India). In the *Statistical Statements* for 1931-32, the total loan due by individuals in the U. P. is shown as Rs. 48 lacs and the amount of overdues is recorded as Rs. 55 lacs. This is clearly inaccurate. A reference was made to the Registrar of Co-operative Societies in the U. P. who kindly pointed out that Rs. 48 lacs was a misprint for Rs. 78 lacs. The percentage has been calculated on the basis of this latter figure.

TABLE 30.

TON-MILEAGE OF CLASS I RAILWAYS.

(Data from *Review of the Trade and Railway Board Report.*)

Year.	Net ton-miles (in millions).	Index No. 1927-28=100.
1927-28	21,620	100
1928-29	21,645	100.1
1929-30	21,265	98.4
1930-31	20,146	93.2
1931-32	18,107	83.8
1932-33	16,978	78.5
1933-34	18,460	85.4
1934-35	20,091	92.9
1935-36	20,202	93.4

therefore been omitted and the data on the boundary dates alone have been shown in Table 31. This procedure is not justified in the period from January, 1933 to March, 1936, the closing month of our narrative. In the first place, it is much longer than any of the three phases of the depression. In the second place, there was no strongly marked movement either up or down. Accordingly quarterly figures and relative charts have been inserted in Lecture No. IX where we propose to discuss the problem of "Recovery and After".

Production of cotton goods and coal.

By far the more important production in India is agricultural production, the incidence of the depression on which during the past few years has already been shown in Table 29. For industrial production two series have been shown in Table 31, *viz.*, production of coal and of cotton piece-goods, as the production figures for other industries are available only for very recent years. Cotton being a protected industry does not reflect the general condition of production. It will be apparent from the table that it records almost an uninterrupted progress, practically during all the phases of the depression. On a closer analysis, however, it will be seen that the *rate* of increase was not uniform; during the twelve months preceding the depression it was about 20 per cent.; during the nine months of the first phase it was 6 per cent., the corresponding annual rate being 8 per cent. $[(6 \times 12) \div 9]$; during the fourteen months of the second phase it was 8 per cent., the corresponding annual rate being 7 per cent. $[(8 \times 12) \div 14]$ and during the sixteen months of the third phase it was 27 per cent., the corresponding annual

TABLE 31.
PRODUCTION AND FINANCE.
[Main Source: Monthly Survey of Business Conditions in India].

(1)	(2)	Production.		Finance.						
		Coal (in thousands of tons)	Cotton piecegoods (in millions of yards).	C2 lutta index number of whole-sale prices. Base: July, 1914.	Bombay Cost of Living Index number. Base: July, 1914.	Active circulation of notes (in crores of rupees.) Data from annual reports of Controller of Currency.	Unadjusted clearing figures (in crores of rupees).	Index number for 3½% G.P. Notes. Base: July, 1914.	Index number for non-speculative securities. Base: July, 1914.	Index number for speculative securities. Base: July, 1914.
Pre-depression year.	Average for September 1926, 1927 and 1928	1850	168.3	146	151	156.0	158.3	78	111	227
	September, 1929.	1875 (101)*	202.4 (120)*	143 (98)*	149 (99)*	159.0 (102)*	155.4 (98)*	72 (92)*	110 (99)*	240 (106)*
	Change during pre-depression year. June, 1930.	+1%	+20%	-2%	-1%	+2%	-2%	-8%	-1%	+6%
First phase of the depression—	October 1929 to June, 1930 (9 months).	1754 (95)	215.2 (128)	116 (79)	140 (93)	152.9 (98)	129.1 (82)	68 (87)	98 (88)	206 (91)
Second phase of the depression—	Change from September 1929 to June 1930 August, 1931.	-6%	+6%	-19%	-6%	-4%	-18%	-6%	-11%	-14%
July 1930 to August, 1931 (14 months).	Change from June 1930 to August 1931.	1285 (69)	233.0 (137)	92 (63)	108 (72)	135.9 (87)	127.9 (81)	62 (80)	90 (81)	116 (51)
Third phase of the depression—	Change from June 1930 to August 1931.	-27%	+8%	-21%	-23%	-11%	-1%	-9%	-8%	-44%
September 1931 to December, 1932 (16 months).	Change from August 1931 to December, 1932	1596 (86)	295.0 (175)	88 (60)	110 (73)	158.1 (101)	133.9 (85)	76 (97)	101 (91)	150 (66)
January 1933 to March 1936 (39 months).	Change from August 1931 to December, 1932	+24%	+27%	-4%	+2%	+16%	+5%	+22%	+12%	+30%
	Change from Sep. 1926, 27, 28 to December 1932 March, 1936.	-14%	+75%	-40%	-27%	+1%	-15%	-3%	-9%	-34%
	Change from December 1932 to March, 1936.	1877 (101)	293.1 (174)	91 (62)	102 (68)	168.8† (108)	135.7 (86)	102 (131)	135 (122)	212 (93)
	Change from Sept. 1926, 27, 28 to March, 1936.	+18%	-1%	+3%	-7%	+7%	+1%	+34%	+34%	+41%
		+1%	+74%	-38%	-32%	+8%	-14%	+31%	+22%	-7%

* Figures within brackets indicate the respective percentages, assuming that the average for September 1926, 1927 and 1928 was 100.

† The amount of notes issued less those held in the Banking Department of the Reserve Bank.

rate being 20 per cent. $[(27 \times 12) \div 16]$. Thus it is only during the last phase that the pre-depression rate was attained. It may also be noticed that the rate during the second phase was somewhat less than that during the first phase, which in its turn was less than half of the pre-depression rate. The above tedious calculation is made in order to test to what extent Indian cotton industry was affected by the depression, for the Hon'ble Sir George Schuster referred on several occasions to the condition of this industry in support of his view that depression had not created as much distress in India as elsewhere. Apart from this, even if the industry had really been as prosperous as stated by Sir George Schuster, it would have on the other hand showed what great sacrifices had to be made by unsheltered industries, specially agriculture, to make this possible.

The production of coal offers a better indication, not only with regard to industrial conditions but also, as regards railway traffic in view of the heavy amount of coal consumed by Indian railways. On the other hand, it has to be remembered that coal had been in a bad way in India for several years before the depression began. Even when allowance is made for this, the deterioration during the first phase as compared with the pre-depression year, the aggravation during the second phase and the slowing down of deterioration during the third phase are clearly noticeable. It is also seen that even after December, 1932, the production was 14 per cent. less than during the pre-depression period, a distressing feature which loudly calls for amelioration.

If other production figures had been considered, they would not have shed more light on the darkness of the depression. We therefore proceed to consider some financial data reproduced in Table 31 partly because they reveal trade conditions better, but chiefly because they are intimately connected with the currency conditions.

Calcutta wholesale prices and Bombay cost of living.

Columns (5) and (6) of Table 31 record changes in the Calcutta Index number of Wholesale Prices and the Bombay Cost of Living Index number during the three phases of the depression and also during the previous period. It will be seen that during the first phase, the former fell more than the latter, showing the comparative rigidity of retail prices as compared with wholesale prices, and the equally "sticky" nature of other components of the cost of living index such as rent. During the second phase, this friction was almost completely overcome, the decline being 21 per cent. in the former case and 23 per cent. in the latter case. During the third phase both of them remained fairly steady. On the balance, however, wholesale prices by December, 1932 were 40 per cent. below the pre-depression level, whereas cost of living was 27 per cent below the corresponding level. Whether there has been so

great an increase in the purchasing power of the rupee as that, is a debatable point, partly because the basis of the index is too narrow, but chiefly because of the wide divergence in the standard of living in different parts and among different communities in India. These points will be discussed in the concluding lecture.

Active circulation of notes.

In column (7) of Table 31 are recorded the figures for the active circulation of notes. Curiously enough, in the *Monthly Survey* gross circulation figures alone are published. It was, however, thought advisable to consider the active circulation in the hands of the people. Such figures are reproduced from the annual reports of the Controller of Currency in India in column (7) of Table 31. It will be noticed that during the year preceding the depression, neither the note issue nor the wholesale index nor the cost of living index recorded any serious fluctuation. During the first phase of the depression and also during the second stage, note circulation was restricted, but probably not to the extent warranted by the fall in wholesale prices and cost of living. On the other hand, it is common knowledge that the quantum of trade also declined at the same time, although statistics could not be given for reasons stated above. Thus the trade demand for money fell for a double reason, firstly, because prices were lower and secondly, because quantities were smaller. On the other hand, it is well known that during a depression, the velocity of circulation whether of notes or of deposit currency greatly diminishes. To compensate for this, an increased volume of currency is usually called for. It is difficult therefore to determine in the absence of the necessary figures whether currency was "starved" as popularly supposed, or properly adjusted to demands, as claimed by Sir George Schuster.

Clearing figures and stock exchange prices.

Clearing figures given in column (8) reflect not only trade conditions but also financial and stock exchange operations. The increase recorded in the third phase is probably due more to financial operations than to trade revival. Evidence for this is afforded in columns (9), (10) and (11). It will be seen that during the third phase of the depression $3\frac{1}{2}$ per cent. Government Promissory Notes, non-speculative securities and speculative securities all recorded substantial increases in value. It is curious to notice that the difficulties of Indian public finance in the period immediately preceding the depression, were responsible for a heavier fall in Government securities than in non-speculative securities but this position was reversed during the first phase, the former falling by 6 per cent. and the latter by 11 per cent. During the second phase, the two fell at about the same rate, whereas during the third

phase, the rise in the price of Government securities was spectacular compared with that of non-speculative industrial securities. Speculative securities also recorded a sensational rise during the third phase, but the havoc caused during the first phase and more so in the second phase was so great that the wastage could not be made good during the third phase at the end of which speculative securities were 34 per cent. below the pre-depression level, whereas Government securities and to a less extent non-speculative securities were practically brought back to the pre-depression level.

This improvement in the price of Government securities was partly due to the improvement in the political outlook in the country. The Gandhi-Irwin pact was concluded on the 5th March, 1931 and by the end of May, some improvement in the political situation was discernible in most of the provinces. But this was more than neutralised by worsening of the financial position of Government which culminated in the financial crisis of September 1931, leading to two out-standing currency events of the last phase of the depression, *viz.*, the linking of the rupee to sterling and the exodus of gold, which will be discussed in the next lecture.

LECTURE VIII.

CURRENCY EVENTS DURING THE DEPRESSION.

In the last lecture the course and phases of the depression in different countries of the world and their repercussions on Indian economic life were described. In the present lecture, the two chief events of the depression, *viz.*, the linking of the rupee with sterling and gold export will be discussed. The policy of silver sales by the Government of India, although inaugurated long before the depression, even before the pre-depression crisis, became important with the return of redundant rupees from circulation, during the course of the depression, and their disposal by the Government of India will be examined before we discuss the two chief events of the depression.

Silver sales and their effect.

The Hilton Young Commission rightly observed that silver reserves were ordinarily out of place in a gold standard system and had recommended that the silver holding in the Paper Currency Reserve should during a transitional period of ten years be reduced to Rs. 25 crores only.

Following this recommendation, the Government of India began their silver sale as early as 1927. At first the sale was confined to the Government stock of uncoined fine silver bars but later on rupees were melted and sold in the form of bars. With the deepening of the course of the depression, more and more rupees began to return to Government and silver sale went on apace.

Partly, as a revenue measure, partly to support the price obtained from the sale of melted rupees, and partly "to increase the value of the silver holdings of the Indian people", the Indian budget for 1930-31 provided for the reimposition of the import duty on silver which had been discontinued in 1920. The duty was fixed at 4 annas per ounce (troy), effective from March 1, 1930, while an excise duty of the same amount was imposed on Indian production of silver, with effect from March 17, 1930. The duty was further raised to 7½ annas per ounce (troy) by the emergency budget in September, 1931 but was subsequently reduced first to 5 annas and then to 2 annas per ounce.¹

¹ Budget speech of the Finance Member, Government of India for 1935-36, p. 13.

Such sale by the Government of India had a depressing effect on the world price of silver. Almost the only positive achievement of the World Economic Conference of 1933, was the silver agreement entered into in July, 1933 by India and certain other countries having silver interests. Under this agreement the Government of India agreed not to sell more than 140 million fine ounces of silver during the four years beginning from 1st January, 1934, i.e., an average of 35 million fine ounces a year, subject to a maximum disposal of 50 million ounces in any year. The total quantity of silver sold by the Government of India from the beginning of their operations up to 31st March, 1935, amounted to 228 million fine ounces.

The great bulk of this silver, amounting to some 211 million ounces, was exported, on Government account, mainly to the United Kingdom¹ during the period. This will be clear from Table 32 given below. The table is otherwise interesting. It shows that India which is normally a silver-importing country, was transformed into an exporter of silver with effect from the year 1931-32. It may also be noted that in spite of the depression, the net import of silver into India in 1930-31 was higher in value than in 1928-29 and in 1929-30. The reason, as suggested by Prof. Gregory,² is that the fall in the gold value of silver in 1930-31 was greater than that of Indian commodities in general. It was not therefore surprising that our consumption of silver increased during the year. But in 1931-32, our import of silver dropped by about Rs. 9 crores. Apart from the severity of the depression, the increase in the Indian import duty on silver combined with a rise in its price, was responsible for this decline. The ready price of bar silver in London per ounce standard which was 13*d.* in September, 1931, rose to 17.3*d.* in October and 21.3*d.* in November next. This rise in the price of silver was accelerated by the silver policy³ inaugurated by the U.S.A. government in 1933. There

¹ The only important exception was the export in 1933-34. The total export of silver on Government account during the year was 50.9 million ounces, out of which 29.2 million ounces went to the United Kingdom and 21.6 million ounce to the U.S.A. The latter was utilised by the British Government in making part payment of the War Debt to the United States Government. This is the reason why the maximum of 50 million ounces was allowed to be exceeded this year. It may be noted here that any silver for the purpose of payment of War Debt to the U.S.A. Government was excluded from the scope of the agreement, subject only to this limit that the total sale from India during the four years should not exceed 175 million fine ounces.

² T. E. Gregory—*The Silver Situation, Problems and Possibilities*. (Manchester, 1932), p. 20.

³ By a proclamation issued on December, 21, 1933, the U.S.A. ratified the Silver Agreement in London by which it undertook, until 1937, to absorb annually not less than 24.4 million ounces of silver. Though the purchase was confined to silver mined in the U.S.A., it had a stimulating effect on the world price of silver. The Silver Purchase Act passed in June, 1934 was of more importance. It directed the Secretary of the Treasury in the U.S.A., to purchase (but at his discretion) silver at home and abroad until it equalled in value one-third of the monetary stocks of gold held by the Treasury or until the market price of silver should reach \$1.29 an ounce.

was a further decline in the import and a corresponding increase in our export of silver, specially on Government account, with effect from the year 1933-34. From the beginning of the year 1936, the price of silver has, on the whole, remained fairly steady at about 20*d.* an ounce, with the result that the export from India has diminished while the inflow has increased. In fact, the value of the net import of silver into India in 1936-37 practically reached the level of 1927-28.

TABLE 32.
EXPORT AND IMPORT OF SILVER.
+ indicates net export from India.
— indicates net import into India.

[Data from (1) the *Annual Review of Trade of India and*
(2) *Annual Statement of the Sea-borne Trade of British India, Vol. I.*]

Year (April to March.)	Import (in lakhs of rupees)			Export (in lakhs of rupees.)			Net import—(in lakhs of rupees) [(4)–(7)].	Net export—(in lakhs of rupees) [(7)–(4)].	Gross export on Government account (in millions of fine oz.).
	Private.	Government	Total [(2) + (3).]	Private.	Government	Total [(5) + (6).]			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Pre-war average 1909-10 to 1913-14	10.88	3.53	14.41	3.67	1	3.68	– 10.73	..	..
War average. 1914-15 to 1918-19	4.56	22.37	26.93	1.77	1.27	3.04	– 23.89	..	..
Post-war average 1919-20 to 1923-24	14.18	6.16	20.34	2.66	11	2.77	– 17.57	..	..
1927-28	16.44	3	16.47	2.59	5	2.64	– 13.83	..	0.3
1928-29	15.92	..	15.92	2.88	3.27	6.15	– 9.77	..	22.5
1929-30	13.36	6	13.42	1.47	3.32	4.79	– 8.63	..	25.5
1930-31	13.46	7	13.47	1.81	1.57	3.38	– 10.09	..	15.4
1931-32	4.42	7	4.43	1.83	3.02	4.85	..	+ 42	30.1
1932-33	1.63	0.08	1.63	90	2.74	3.64	..	+ 2.01	25.0
1933-34	81	6	82	80	6.38	7.18	..	+ 6.36	50.5
1934-35	4.45	0.02	4.45	4.08	5.78	9.86	..	+ 5.41	41.0
1935-36	4.46	2.00	6.46	3.19	3.84	7.03	..	+ 57	..
1936-37	13.87	..	13.87	28	..	28	– 13.59	..	..

The London price of silver which was 19.4*d.* in May, 1934, rose to 24.5*d.* by the end of the year. In May, 1935, it was 33.7*d.* Then it began to fall and reached 19.7*d.* in March, 1936. (*Report on Current Economic Conditions, Memorandum No. 63 of the Royal Economic Society.*)

We have already seen that with the beginning of the second phase of the depression after June, 1930, its full brunt began to be felt in India. In fact, the year 1931-32 proved to be a critical one in the history of Indian currency. The collapse of prices and serious decline in trade created a very difficult situation for Government finance, both central and provincial. The budget of the Central Government for 1931-32 was estimated to provide a surplus of Rs. 31 lakhs but in spite of a 10 per cent. emergency cut in the salary of Government servants and a supplementary budget imposing new and increased taxation, the year closed with an actual deficit of Rs. 11.75 crores.

Exchange crisis during first half of 1931-32.

From the point of view of currency and exchange, the year may be divided into two distinct periods—(a) from April to September, and (b) from October to March next. Throughout the first period, the exchange position was quite serious. The closing rate of exchange for the preceding year was 1s. 5 13/16d. That rate continued to rule in the market with slight variations during April and May. Large offers of treasury bills at high rates kept the exchange rate from falling to the lower gold point. During the period April 1 to October 24, 1931, there was no remittance to the Secretary of State for India in Council by means of purchases of sterling in India, but £23,047,800 was transferred to the Home Treasury from the Gold Standard Reserve in England, against gold transferred in India from the Paper Currency Reserve to the Gold Standard Reserve. These deflationary measures for keeping up the exchange rate proved futile. The position became distinctly worse at the end of May with the comparative failure of the Indian sterling loan in London. From the beginning of June, the Government began to sell Reverse Councils to whip up the exchange rate. Then came the announcement of the British Premier on the 27th of June, assuring us of the support, if necessary, of the British Government, for maintaining our currency and credit. This had a salutary effect on the rupee-sterling rate which rose to 1s. 5 13/16d. on the 13th of July. This improvement was, however, temporary, for the exchange rate sagged to 1s. 5 3/4d., i.e., just below the gold export point, on the 21st of July. This was mainly due to financial stringency in Great Britain and Central Europe. Investment in Indian treasury bills on foreign account ceased and there was a tendency to bring back the funds which had already been invested in India. Throughout the months of August and September, the rupee-sterling rate remained just below the gold export point. Altogether Reverse Councils worth £14 millions were sold by Government during the four months from June to September.

Suspension of the gold standard in England.

At this critical juncture, Government of India received on the morning of September 21, 1931, the information that British Govern-

was a further decline in the import and a corresponding increase in our export of silver, specially on Government account, with effect from the year 1933-34. From the beginning of the year 1936, the price of silver has, on the whole, remained fairly steady at about 20*d.* an ounce, with the result that the export from India has diminished while the inflow has increased. In fact, the value of the net import of silver into India in 1936-37 practically reached the level of 1927-28.

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Suspension of the gold standard in England.

At this critical juncture, Government of India received on the morning of September 21, 1931, the information that British Govern-

ment had decided to suspend the gold standard. This would have produced a serious financial crisis in India, for our position was then quite vulnerable and that for two reasons, each equally grave. In the first place, our gold and sterling securities in Paper Currency and Gold Standard Reserves amounted on that date only to Rs. 57·82 crores against a note issue of some Rs. 146 crores. Secondly, our floating debt in the shape of Indian Treasury Bills (with the public and in the Paper Currency Reserve) was then as much as Rs. 80·78 crores. This entire amount together with Rs. 20 crores worth of short term debt, was due to mature within the next twelve months.

Measures adopted by Indian Government.

Three measures were immediately taken on the 21st of September by our currency authorities—(1) the bank rate of the Imperial Bank was raised from 7 to 8 per cent. simultaneously with the rise in the Bank of England rate from $4\frac{1}{2}$ to 6 per cent., (2) Ordinance No. VI of 1931 was issued relieving Government from their obligation under the Currency Act of 1927 to sell gold or sterling, and (3) the three days 22nd to 24th September were declared public holidays under the Negotiable Instruments Act. The second of these, was a purely temporary measure for taking stock of the situation. It severed the rupee both from gold and sterling and gave it freedom to drift on an uncharted sea—a freedom which lasted however only for three days. The decision to link the rupee to sterling at 1s. 6d. rate was announced by Government on the 24th of September. On the same day Ordinance VII of 1931 was passed. It cancelled the Ordinance issued on September 21 and limited sales of gold or sterling “to finance required by recognised banks for the following purposes:—(1) normal trade requirements, excluding the import of gold or silver and the liquidation of the oversold exchange position of any bank in respect of any month subsequent to the month in which the demand for gold or sterling might be made; (2) contracts completed before the 21st September; and (3) reasonable personal and domestic purposes”.

The system of exchange control introduced by this Ordinance was meant to check the flight from the rupee. It was feared that Indians might lose confidence in the rupee which had been linked to a currency off-gold and might buy with it exchange on gold standard countries. The fear however proved groundless. The Ordinance was therefore cancelled on the 30th January, 1932 and exchange control ceased from that date.

Thus, from September 25, 1931, India again passed on to sterling exchange standard, a system which had been pronounced to be unsuitable for India both by Babington Smith Committee and the Hilton Young Commission. The latter commission had pointed out that “the system

would have grave defects. The silver currency would still be subject to the threat implied in a rise in the price of silver. Were sterling once more to be divorced from gold, the rupee, being linked to sterling, would suffer a similar divorce. Should sterling become heavily depreciated, Indian prices would have to follow sterling prices to whatever heights the latter might soar, or, in the alternative, India would have to absorb some portion of such rise by raising her exchange." All this is no doubt true, but was not the situation in September, 1931 quite different from what was contemplated by the Hilton Young Commission? How far the danger that the rupee might go to the melting pot, was a real one, will be discussed in the concluding lecture. It may however be pointed out, what the Hilton Young Commission really wanted to guard against was soaring price in India but that was exactly the thing which was desired in September, 1931, if it could be attained, without making it more difficult for us to meet our foreign obligations. It is clear therefore that simply because the Hilton Young Commission condemned the sterling exchange standard in 1926, there was no reason why it should be rejected in 1931 on that ground alone. A deeper analysis is required for accepting or rejecting it.

The various alternatives.

Four different courses were open to us on September 21, 1931:—

- (1) To adhere to the gold standard at 1s. 6d. (gold) rate, i.e., at the rate of 1 rupee=8·47 grains of fine gold.
- (2) To adhere to the gold standard at a rate lower than 1s. 6d. (gold) rate.
- (3) To go off the gold standard but not to link the rupee either to sterling or to any other currency.
- (4) To link the rupee to sterling at 1s. 6d. rate.

Was the first method really feasible and desirable? For about a year before September, 1931, the rupee sterling rate was at or near the gold export point. In spite of deflationary measures, including sale of Reverse Councils, which has already been discussed, the Government of India was finding it extremely difficult to maintain 1s. 6d. (gold) rate. It was perhaps a God-send to Sir George Schuster that England went off the gold standard. It may be pointed out that it is difficult for a debtor country like India to maintain the gold standard, without a sufficiently high reserve, especially under the abnormal conditions brought about by the depression. It should not be forgotten that our exports consist of a few articles subject to great variations in prices. Prof. Frank Graham has of course argued that the greatest ratio of gain from international trade will be obtained by the country which can secure all its imports by the export of one commodity only. But Brazil's reliance upon one commodity, *vis.*, coffee, has created serious difficulties in her

foreign exchange market. In times of depression, the reliance upon a few exportable commodities, makes it extremely difficult for a country which is a debtor in the international capital market, to maintain the gold standard. One should also remember how dangerously low the reserves of India were on September 21, 1931, an alarming feature mentioned already.

Even if we could have maintained 1s. 6d. (gold) rate, it would have meant very severe deflation of currency, especially in view of the gold rush in Europe which began after England's suspension of the gold standard. Since September 21, 1931, many central banks in the West realised their foreign assets and imported gold, with the result that the value of gold began to rise.

Most of the above arguments are also applicable to the second course mentioned above. Moreover, there is an additional difficulty. What would be the lower rate 1s. 5d. or 1s. 4d. or 1s. 3d. or any other rate? If 1s. 4d. (gold) rate, *i.e.*, 7.53 grains of fine gold per rupee, had been adopted, it would hardly have given any appreciable relief to Indian agriculturists. On the contrary, the ryot's position would have changed for the worse on account of subsequent deflation which even 1s. 4d. (gold) would have made inevitable.

Would it then have been desirable for us to follow the third alternative, *viz.*, to go off the gold standard along with England but not to link the rupee to sterling or to any other currency? There has been a widespread demand in the country for this course. It has been argued that the rupee should have been allowed to find its natural level. But is there any 'natural' level for the rupee except its own bullion value? It is not clear whether this demand for a "free rupee not tied to the chariot wheels of sterling" really meant a return to silver standard or it was a plea for joining the race for exchange depreciation. In any case under the abnormal conditions of September, 1931, the so-called "free rupee" would have made our exchange market the play-ground of speculators and we would have had a highly unstable exchange with probably a downward trend. But the benefit expected to be derived from this weakening of exchange would have proved illusory.

Under the special circumstances of India where foreign trade forms a small proportion of her total trade, it was unlikely that Indian prices in general would have risen *pari passu* with the depreciation of exchange.¹ On the other hand, there was a danger that India's exports might have been penalised by foreigners.

Thus the linking of the rupee to sterling was the only practicable course open to us in September 1931. It gave us the advantage of a

¹ This question has been more fully discussed in the next lecture.

regulated inflation along with sterling. It may be noted here that the moderate inflation of 1927 could not be kept under control even in a country like America where the banking system is far better organized than in India. Any attempt to initiate a major inflation in India, by letting exchange "go hang" would have ended only in disaster.

Short period and long period views on sterling exchange standard.

Though the adoption of the sterling exchange standard was the only practicable course for us in September, 1931, it by no means follows that the rupee should be permanently tied to sterling unless the latter approximates to the international standard. It is true that sterling now claims allegiance from a larger number of countries than the almighty dollar, for not only the whole of the British Empire but Norway, Sweden, Denmark and Argentina also belong to the sterling area. It is true that the latter countries are not bound together in a rigid monetary union but it is equally true that the position of sterling in the Empire countries, was considerably strengthened by 1935 with the completion of a chain of Central Banks. The Commonwealth Bank of Australia was transformed into a Central Bank during the period 1924-1932. South Africa had a Reserve Bank of her own as early as 1920. New Zealand Reserve Bank has been working from 1934 and Indian and Canadian Central Banks have been functioning from 1935. The holding of "English sterling" reserves, as provided in the amendment to the Commonwealth Bank Act passed in May, 1932, the obligation of New Zealand Reserve Bank to buy and sell sterling, together with the provisions of the Indian Reserve Bank to hold its reserve in gold or sterling, constitute a definite legal basis for the sterling exchange standard. South Africa and Irish Free State are also operating such a standard. Canada alone, due to her close connection with the U.S.A., evidently desires that her Central Bank should operate the gold standard in the near future.¹ This will be evident from the comparatively large holding of gold in her reserve. On the 30th June, 1936, of the total reserve of the Bank of Canada, 95 per cent. consisted of gold coin and bullion. Though Canada is thus a doubtful vassal, the recent devaluation of the franc has increased the number of adherents of the sterling exchange standard. Greece, Latvia and Turkey have all forsaken the French franc for British sterling. From the beginning of 1934, Japanese currency has been practically linked to sterling at an average rate of 1s. 2d. per yen.

¹ "The Canadian dollar began to depreciate with the suspension of the gold standard by the United Kingdom, but the fall in its gold value was moderate—about 12 per cent. until January, 1933. Between April, 1933 and the end of January, 1934, the Canadian dollar depreciated with the United States dollar. . . . Since the *de facto* stabilisation of the United States dollar, the Canadian dollar, when not at parity with the pound or the United States dollar, has taken an intermediate position."

[*Money and Banking*, 1936-37 (Geneva, 1937), Vol. I; p. 20.]

In spite of this enlargement of the sterling area, the linking of the rupee to sterling for a period sufficiently long, spread over both depression and boom in a trade cycle, might give rise to some difficulties. For example, if sterling now begins to appreciate in terms of commodities and services, we shall have to deflate our currency in order to maintain our exchange rate, even though we may be passing through a depression at the time. On the other hand, if sterling depreciates during a period when there is a boom in India, she would have to follow sterling prices to whatever height the latter might go or in the alternative, she would have to raise her rate of exchange. It is conceivable that neither of these might be to India's advantage. But a study of the British monetary policy during the last five years shows that such fears are not of any practical importance, at least in the near future.¹

Bounty on imports from England.

Two arguments have been advanced by some critics who admit that the linking of the rupee to sterling was an evil necessity when the financial crisis broke out in September, 1931, but are of opinion that "the fetish of stability in terms of sterling" has outlived its usefulness. Their argument is that this has given England a preference in Indian import trade. But it is not realised by such critics that linking or no linking, so long as sterling was depreciating in terms of gold, England would have this preference in our import trade as compared with gold standard countries. The case of Japan is an instance in point. India did not link her currency with the yen but Japan nevertheless enjoyed an advantage in her exports to India as well as to other countries.

Was gold export due to link with sterling?

The other argument is that the linking of the rupee in terms of sterling, has been responsible for gold export from India. As against this, it has been pointed out that even if we had not linked our currency to sterling but had merely been off gold, the yellow metal would have left the country. This is not wholly true. For, it must be recognised that the linking of the rupee with sterling, made it possible for gold to be exported, even if there was a very small margin between sterling and rupee prices of gold. Had there been no linking between the depreciated rupee and depreciated sterling, the margin should have been much wider, to cover the extra risks due to instability of the exchange rate. Thus the condemnation of the linking of the rupee to

¹ Thus in April, 1937, when it was apprehended that trade recovery in India might be retarded by an appreciation of sterling to which the rupee had been linked, Mr. Chamberlain assured the House of Commons that the British Government had no intention of checking the rise in commodity prices in England by raising the value of sterling in terms of gold.

sterling hinges on the validity of the contention that gold export was prejudicial to India's interest,—a question which must now be examined.

An abnormal feature in Indian economics.

It is true this gold exodus, especially on the scale in which it began after the linking of the rupee to sterling, is very unusual in our economic history. From time immemorial, import of precious metals has been a normal feature of Indian foreign trade. Pliny complained about 77 A.D. that India drained the Roman Empire of 55 million sesterces or £458,000 worth of gold and silver every year. It was but natural that he should describe India as a "sink of precious metals" a charge which has been repeated by subsequent foreign writers. This inflow of precious metals was one of the factors which made it unnecessary for India to adopt a policy of mercantilism when it arose in Europe in the sixteenth and seventeenth centuries.

It is not of course implied that India was never an exporter of gold in the past. To quote a few recent instances, the net export of gold from India on private account, was valued at Rs. 1·15 crores in 1915-16 and at Rs. 2·79 crores in 1921-22. But such exports sink into insignificance when we compare them with the amount which left the country during the five years 1931-32 to 1935-36. The relevant figures are given in Table 83.

It appears from the table that net export of gold from India during the last five years was more than one-fourth of the total production in the whole world, excluding U.S.S.R. As the annual output of gold in this country is not even 2 per cent. of the world production, the great bulk of the Indian export obviously came out of the quantity previously imported into the country which had been lying hoarded, partly in the form of bullion but mainly in the form of ornaments.

Two classes of gold sales within the country.

What were the factors that led to the flow of this hoarded gold first to the bullion markets of India and afterwards to foreign countries? The former movement began much earlier than the latter. It was in progress during the second phase of the depression when it was deepening more and more. During the closing months of 1930-31, there was "a considerable return of gold from up-country districts to Bombay. This inflow which commenced in March has been variously estimated at from 5,000 to 6,000 tolas of fine gold a day".¹ The great bulk of gold thus flowing to Bombay roughly up to the end of the year 1931-32 appears to have been "distress" gold sold by people

¹ *Report of the Controller of the Currency for the year 1930-31*, p. 10.

to tide over their economic difficulties. But sale within the country, at least the greater part of it, in subsequent years, was of "investment" gold, that is, of gold which was exchanged for profit and generally for subsequent investment.

TABLE 33.

FLOW OF GOLD FROM INDIA.

+ indicates export from India; — indicates imports into India.

Year (April to March).	Average price* of English bar gold 100 touch per tola. (a)	Net export of gold from India (private).		Balance of transactions (private) in treasure (i.e., gold, silver and currency notes) in crores of rupees.	Balance of trade in merchandise (private) in crores of rupees.	Balance of remittance of funds in crores of rupees.	Total visible balance of accounts in crores of rupees. [(5) + (6) - (7) = (8)]	Year (calendar year).	Annual production of gold in the world (excluding U.S.S.R.) in millions of fine oz. (b)
(1)	(2)	Quantity in millions of fine oz.	Value in crores of rupees.	(5)	(6)	(7)	(8)	(9)	(10)
	RS. AS. P.								
1931-32	24-12-0	+7.63	+57.97	+55.65 ^d	+32.74 ^d	-34.32	+54.07 ^d	1931	20.61
1932-33	29 -4-6	+8.35	+65.52	+64.93 ^e	-12 ^e	-48.63	+16.18 ^e	1932	22.39
1933-34	31-12-3	+6.70	+57.05	+57.23	+33.02 ^e	-60.44	+29.81 ^e	1933	22.73
1934-35	34-11-6	+5.69	+52.54	+52.54	+19.31	-49.78	+22.07	1934	23.34
1935-36	35 -4-4	+4.02 ^c	+37.36 ^c	+36.37	+29.90 ^a	-46.45	+19.82	1935	24.76

* Government buying price of gold, according to the Currency Act of 1927= Rs. 21-3-10 per tola of fine gold.

(a) From the *Review of the Trade of India*, 1935-36.

(b) From the *Statistical Yearbook of the League of Nations*, 1935-36. Kilograms converted to troy ounces at 1 kg.=32.1507 oz. (troy). The remaining figures in the table except those for 1935-36 are taken from *Reports of the Controller of Currency* (for India) 1931-32 to 1934-35.

(c) Taken from *Annual Statement of the Seaborne Trade of British India* for the year ending 31st March, 1936, Vol. I, Table No. 16; p. 886.

(d) Revised figures from the *Report of the Controller of the Currency* for 1933-34, p. 51.

(e) Revised figures from the *Report of the Controller of the Currency* for 1934-35, p. 41.

The effect on prices of these two kinds of gold sales within the country, was somewhat different. "Distress" gold, so far as it was not utilised, to meet the dues of the money-lender or of the landlord, should result in an immediate rise in prices brought about by an increase in the volume of purchase of consumption goods. Such sales of gold would thus reflect themselves in an increase of retail transactions. But later on when this gold would pass into the hands of the bullion dealers, its effect on prices should be the same as that of "investment" gold, *viz.*, increased demand for Government securities, larger purchase of postal cash certificates and increased deposits in postal and other banks.

Thus it is clear that the immediate rise in the Calcutta wholesale index number in October, 1931 and in the next two months, must have been partly due to the sale of "distress" gold. The sudden increase in the absorption of small coins during the year 1931-32, also roughly indicates an increase in the number of retail transactions.² The absorption of whole rupees and notes, which may be required for 'financial circulation' is not as good an index of the changes in retail transactions.

Gold export and its causes.

But whether it was originally 'distress' gold or "investment" gold, gold began to leave the country, regularly after September, 1931. What led to this export from India? Many reasons have been advanced. One is that it was sent out for correcting our unfavourable balance of payments. As Prof. Viner has shown, the dominant tradition in English Political Economy with regard to this question, has been J. S. Mill's theory that an unfavourable balance of payments necessitates a change in the relative price levels, and bullion will move until relative prices in the paying and the recipient areas are such as to enable the new excess of payments over receipts to be met by the export of goods. To quote Mill's actual words "Disturbances of the equilibrium of imports and exports, and consequent disturbances of the exchange, may be considered as of two classes; the one casual or accidental, which, if not on too large a scale, correct themselves through the premium on bills, without any transmission of the precious metals; the other arising from the general state of prices which cannot be corrected without the subtraction of actual money from the circulation of one of the countries, or an annihilation of credit equivalent to it, since the mere transmission of bullion (as distinguished from money) not having any effect on prices, is of

² According to the *Report of the Controller of the Currency* for the year 1934-35, p. 80, the withdrawal of small coins from circulation in India in 1930-31 = Rs. 66 lakhs. In 1931-32, the addition of such coins to circulation = Rs. 19½ lakhs, *i.e.*, from — 66 lakhs, it changed to plus 19½ lakhs.

no avail to abate the cause from which the disturbance proceeded".¹ As India was off gold, our gold export could not be due to the necessity of correcting any disequilibrium in trade by a relative change of prices.

Adjustment of balance of payments.

There is another variant of this contention, *viz.*, gold export was necessary merely for liquidating the debit balance of payment already incurred. But the figures given in Table No. 33 does not fully support this view. According to this table, the total visible balance of accounts in our favour, after meeting the foreign obligation for the year 1931-32 was Rs. 54·07. But our net export of gold during that year, was valued at Rs. 57·97 crores. The great bulk of it was therefore not utilised for meeting our adverse balance.

It is true that our annual balance of accounts cannot be accurately calculated. But it is equally true that this balance need not *always* be adjusted to the nearest pie at the end of every financial year. Sir George Schuster said before the Committee on Monetary and Financial Questions relating to the Ottawa Conference in 1932 that "apart from movements of capital or the country's requirements for the purchase of precious metals, India in order to maintain an even position requires a favourable trade balance of at least 50 crores annually."² As our balance of trade in merchandise in 1931-32 was Rs. 32·74 crores, we could have therefore met our normal foreign obligations that year by sending abroad about one-third the actual quantity of gold exported.

Real reason for gold export.

In fact the explanation, as stated already, of our gold export is quite simple. Gold as a commodity, was relatively cheap in India and this is why it was exported. So long as the rupee was linked to gold, it was not usually profitable to export it. But the situation changed completely in September, 1931. The rise in the rupee price of gold, not coming up immediately to the full extent of the depreciation of sterling in terms of gold, the export of the metal afforded a profit to Indian bullion dealers. This has been very clearly explained in the Statistical Appendix to Dr. H. Sinha's article on Indian Gold Exports in the *Indian Journal of Economics* of April, 1933.

Measures suggested.

As Government allowed this gold export to go on uninterrupted, the Federation of the Indian Chambers of Commerce at their fifth

¹ J. S. Mill—*Principles of Political Economy* (Ashley's edition) Book III, Ch. 20, p. 618.

² *Appendices to the Summary of Proceedings of the Imperial Economic Conference at Ottawa, 1932*, pp. 158-159.

annual meeting held at Delhi on the 26th and 27th March, 1932, criticised the "let alone" policy of Government and passed the following resolutions:—

- (a) an immediate embargo on the export of gold;
- (b) purchase of gold by Government on the basis of day to day ruling rate.

The difficulties in the way.

What were the difficulties in giving effect to these resolutions? The question whether the export of gold from India should have been allowed to go on unrestricted or not, hinged on whether the bulk of the export was "distress" gold or "investment" gold. If it belonged to the former category, free export was necessary in the interest of those who had been compelled to part with their gold on account of severe economic distress.

As most of the gold exported during 1931-32 was "distress" gold, the "let alone" policy of Government was quite justifiable. A policy of gold purchase by Government along with an embargo on export, suggested in some quarters, was then out of the question. How much gold was Government to purchase at the time? Should it have equalled the amount actually exported from India in 1931-32, valued at Rs. 57.97 crores? If the funds for purchasing such a huge amount had been raised by a loan, the burden of interest charged at the existing high rate of nearly $5\frac{1}{2}$ per cent., would have proved very heavy on the Indian tax-payer, apart from the possible loss due to the future fall in the value of gold so purchased. But is not the condition different to-day? In his Budget speech in February, 1933, Sir George Schuster pointed out that most of the gold exported during the financial year which was then closing, was "investment" gold. If that was so in 1932-33, it stands to reason that very little "distress" gold was exported in subsequent years when the economic situation showed some improvement.

What, then, was the objection against restricting gold exports after March, 1932? The reason given by Sir George Schuster was, "The broad fact is that India could not with exports at their present level support the present volume of imports simultaneously with meeting her external obligations unless they are supplemented by gold exports". He had explained this more fully in his speech at the Ottawa Conference. According to him, a reduction of imports by causing loss of customs revenue which was the main stay of central government finance, "would create a completely impossible budgetary position". If, on the other hand, imports did not decline, India would be unable to meet her external obligations except by raising loans abroad. How was this conundrum to be solved? The abnormal fall

in our export surplus in 1932-33 (this year there was an actual deficit amounting to Rs. 12 lakhs) and also in 1934-35, shows that the choice before India, at least during these two years was really this—whether it was desirable to create active liability for the Government in the shape of foreign loans, for the sake of preserving dead assets of gold in the country. It must not be forgotten that gold which left the country came out of private holdings and not out of the currency reserves of the Government. Thus there was no cause for raising the alarm that the country was rushing head-long to financial bankruptcy, on account of the “drain” of gold abroad.

Incidence of export duty.

But a critic might ask if Sir George Schuster really wanted free export of gold for the sake of custom duties on imports, as stated in his speech before the Ottawa Conference, could not the same object have been fulfilled by levying an export duty on gold? There was recently a proposal for an export duty on gold in the central legislature, but not on the ground stated above. In the course of the debate on the Finance Bill before the Council of State in April, 1935, Sir James Grigg objected to the proposal on the ground that “it would have ultimately fallen on the seller, who as a rule was a poor person with only a small stock of gold”. This does not however appear to have been the case, for, as pointed out above, it was only during the last stage of the second phase of the depression that such “distress” gold was sold to bullion dealers. On the other hand, it must be recognised that the incidence of the export duty would fall mainly on the Indian seller. It is true that the export of gold from India forms a substantial part of the annual world output, but it forms nevertheless a very small portion of the total world stock. Any export duty on Indian gold is therefore not likely to raise its price abroad to any appreciable extent. But the question is, who is the person who pays this tax? Is he a needy cultivator obliged to take away ornaments from the person of his wife? Or is he a bullion dealer, who exports or does not export accordingly as it is profitable or unprofitable? If such a bullion dealer is obliged to reduce his buying price of gold because he has to export at a lower price, he does not pay that reduced price to “a poor person with only a small stock of gold”, who was obliged to part with his gold long ago.

It has been already pointed out that the disparity between the rupee price and the sterling price of gold is really responsible for gold outflow. As this disparity has been created by Government, it is a legitimate source of revenue. Sir James Grigg, in his budget speech on February 28, 1935, rightly pointed out that our revenue tariff was too high and complicated. In fact, the lowering of this tariff, would bring some relief to the Indian agriculturist who has so far gained

little from protective duties on manufactures and from high revenue duties in general. The proceeds of the export duty on gold might very well be utilised for lowering revenue duties on some of the necessities of the Indian ryot. But this export duty should be imposed solely for revenue. It must not be so high as to stop the outflow of gold, for it is difficult to accept the view that the conversion of private gold holdings into interest-bearing assets, does involve national loss. It is now late in the day to sigh for the loss of "distress" gold in 1931-32. As already pointed out, it was not a practical proposition for Government to purchase this gold at the market rate. It was certainly advantageous to the sellers that they obtained a higher price due to unrestricted export than they could have otherwise obtained. If they had pledged their gold with the village money-lender, instead of selling it out-right, it was extremely doubtful whether they could ultimately recover the gold which had once been pledged in this way.

With regard to the sale of "investment" gold, however, it has been argued that the Indian sellers were merely exchanging "solid" gold for depreciated sterling. If we take a short period view of the matter, it may be said that as they were selling this gold of their own free will, it is not unreasonable to assume that they were parting with a commodity having a lower value for one which had a higher one. Even in the long run, it is true that sterling may depreciate, but it is equally true that gold itself, is not free from this danger.

Future value of gold.

The increase in the annual output of gold in the world which has been referred to in Table 33 shows that our problem to-day is not primarily that of shortage of gold. Thanks to a general devaluation of the world's currencies and the consequent rise in the price of gold in terms of these currencies, the monetary stock of gold in the world has increased considerably during the last five years, partly from larger production, as has already been mentioned, and partly from dishoarding of gold by China and India. The fear of gold shortage has vanished. On the other hand, it is apprehended that the world might suffer from a plethora of gold in no distant future. The future value of gold is in any case uncertain. It will depend, above all, on that incalculable factor—the future monetary policy of the leading countries of the world. Even if there is a general return to the gold standard in the near future, the policy of economising monetary gold found successful in the pre-depression period, is not likely to be given up. It may also be taken as practically certain that if and when the gold standard comes back, lower gold parities than those of 1929, will be generally adopted. There is therefore a greater probability of the value of gold falling rather than of rising in future. It seems that

India has done well in converting her dead-stock of gold into interest-bearing assets. It will not be difficult for her to get back her gold on more favourable terms, should such an occasion arise in future.

Speaking quite broadly, this gold export is an *effect* of the depression. But at the same time it is a *measure* for trade revival. To the extent gold export, as pointed out in the *Report of the Controller of the Currency* for 1931-32, "stemmed the headlong fall of commodity prices in India", it benefited the business community. It strengthened also the rupee-sterling exchange and solved the remittance problem of Government. Gold export again has been partly responsible for the rise in the price of Government securities. This will be clear from Table No. 5. In other words, the fall in the long term rate of interest which is a pre-requisite of trade recovery, is partly due to our gold export. Thus it offers one more illustration of the wonderful adaptability of man under changing economic conditions—of his eternal struggle to mould his environment to satisfy his own pressing needs.

LECTURE IX.

RECOVERY AND AFTER.

In Lecture VII it was shown that the entire economic life of India was very seriously affected by August, 1931, after which the *rate* of deterioration in her economic condition somewhat slowed down. The sequence of events up to December, 1932, was traced in that lecture. Both industrial production and quantum of trade in the world reached their lowest level in 1932.¹ Between 1929 and 1932, the gold value of world trade had dropped by about 60 per cent., the quantum by 25·5 per cent. and industrial production (excluding U.S.S.R.) by 37 per cent. Since then there has been a slow but gradual recovery. The quantum of world trade began rising in 1933 and by 1935 it was only 18 per cent. less than that in 1929. Industrial production in the world showed a relatively more rapid progress. By 1935 it was only 16 per cent. below the level of 1929. The gold value of world trade increased by about 8 per cent. in 1936 as compared with 1935 figures. The quantum of trade in 1936 rose by 4 per cent. and reached a level of 14 per cent. below that of 1929. The term of trade which had moved during the depression against primary-producing countries, was now turning in their favour. There was scarcely a single country in the world which failed to experience recovery in trade, though the gold value of world trade in 1936 was only 37·3 per cent. of that in 1929. It now remains for us to describe the trade recovery in India and the currency conditions and problems arising out of it, from January, 1933 to March, 1936, for the present course of lectures is intended to cover the decade up to that date.

Production of coal and cotton piece goods.

In Table 31 of Lecture VII have been given the figures for the production of coal and cotton piecegoods in India on particular dates. The table does not show the course of production during the period under review. It only indicates the extent of the rise and fall on the specified dates. Nothing has been recorded there with regard to the intervening months. This fact is well illustrated by the figures for the production of coal and cotton piecegoods given in Table No. 34 and Chart XII.

¹ *World Economic Survey, 1935-36* (League of Nations, 1936), p. 13. In spite of the slackening of the rate of deterioration, the lowest point of the depression in India was reached during 1932-33.

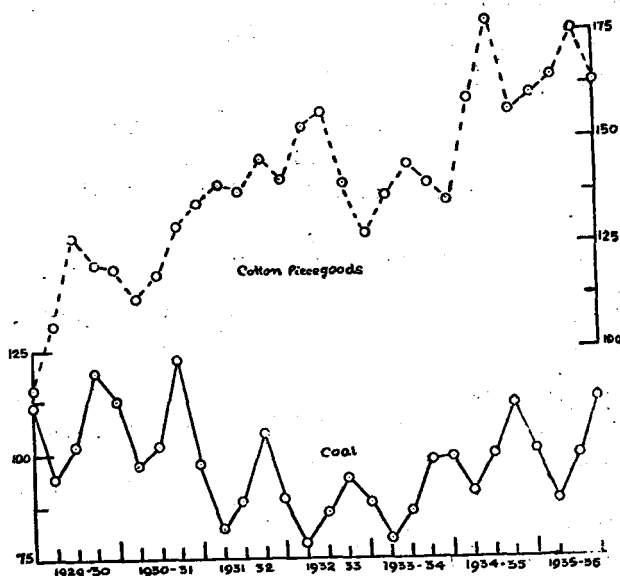
TABLE 34.
 PRODUCTION OF COAL AND COTTON PIECEGOODS (QUARTERLY FIGURES).
 (Data from *Monthly Survey of Business Conditions in India*.)

Year.	Coal in thousands of tons.				Cotton Piecegoods in millions of yards.			
	April-June.	July-September.	October-December.	January-March.	April-June.	July-September.	October-December.	January-March.
Average for 1926-27 to 1928-29	1762	1581	1618	1979	171.8	166.9	186.9	190.9
1929-30	1942 (112)*	1659 (96)	1774 (102)	2183 (120)	172.3 (91)	190.2 (106)	227.1 (127)	216.8 (121)
1930-31	1963 (113)	1692 (98)	1790 (102)	2127 (123)	213.8 (119)	202.9 (113)	212.0 (118)	230.8 (129)
1931-32	1705 (98)	1419 (82)	1521 (88)	1826 (105)	240.9 (135)	249.3 (139)	245.8 (137)	260.6 (146)
1932-33	1538 (89)	1358 (78)	1500 (86)	1625 (94)	250.9 (140)	274.8 (153)	281.6 (157)	249.3 (140)
1933-34	1520 (88)	1366 (79)	1484 (86)	1693 (98)	229.4 (128)	244.5 (137)	257.9 (144)	249.8 (139)
1934-35	1716 (99)	1575 (91)	1717 (99)	1940 (112)	241.4 (135)	284.5 (159)	319.7 (178)	286.7 (157)
1935-36	1754 (101)	1527 (88)	1726 (99)	1952 (113)	288.5 (161)	293.3 (164)	315.1 (176)	292.3 (163)

* Figures within brackets indicate the respective percentages, assuming that the average for the three years 1926-27 to 1928-29 was 100.

CHART XII.

PRODUCTION OF COTTON PIECEGOODS AND COAL.



It is clear from the above table and chart that the production of coal continued low throughout the year 1932-33 and began to increase only from the third quarter of 1933-34. The economic significance of this should not be lost sight of, for, it is evident that in spite of the spectacular rise in the value of Government securities and improvement in other indices described in Lecture VII, the general economic condition began to show a decided improvement only from a subsequent date.

As regards production of cotton piecegoods, sufficient has been said in Lecture VII to show that it cannot furnish a good index of economic activity. Speaking generally, it may be said that the production during 1933-34 was somewhat lower than during 1932-33 and there was a moderate revival during 1934-35 and 1935-36.

Movement of wholesale prices and of cost of living.

The movements of wholesale prices and of the cost of living during the period of recovery have been shown below in Table No. 35 and Chart XIII. The Calcutta Index Number of wholesale prices recorded a small rise but is not free from fluctuation. The highest value reached during this period was 94 in January, 1935, and the lowest value was 82 in March, 1933. It is difficult to distinguish a definitely upward trend. All that can be said is that prices tended to move upwards rather than downwards during this period.

TABLE 35..

WHOLESALE PRICE AND COST OF LIVING INDICES.*

I.

Calcutta Wholesale Prices Index.

Year.	April-June.	July-September.	October-December.	January-March.
Average for 1926-27 to 1928-29 }	146	146	146	144
1929-30	139 (95)	143 (98)	137 (94)	127 (87)
1930-31	120 (82)	113 (77)	103 (71)	99 (68)
1931-32	96 (66)	92 (63)	97 (66)	96 (66)
1932-33	89 (61)	90 (62)	90 (62)	85 (58)
1933-34	87 (60)	89 (61)	88 (60)	89 (61)
1934-35	90 (62)	89 (61)	88 (60)	90 (62)
1935-36	90 (62)	90 (62)	93 (64)	91 (62)

* Figures outside brackets have been calculated from the monthly data as published in the *Indian Trade Journal* in the case of Calcutta Wholesale Prices Index and in the *Labour Gazette*, Bombay, in the case of Bombay Cost of Living Index. Figures within brackets in both the tables indicate the respective percentages, assuming that the average for the three years 1926-27 to 1928-29 was 100.

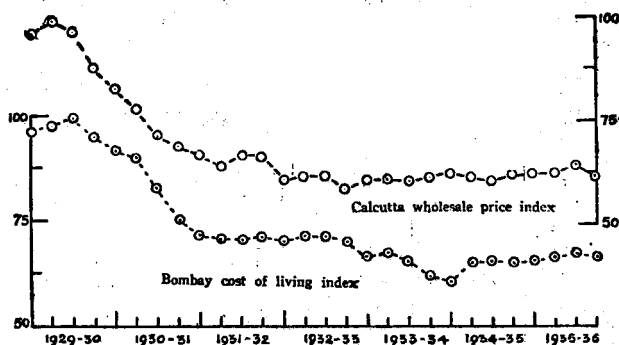
II.

Bombay Cost of Living Index.

Year.	April-June.	July-September.	October-December.	January-March.
Average for 1926-27 to 1928-29 }	151	153	151	151
1929-30	147 (97)	149 (96)	150 (99)	144 (95)
1930-31	140 (92)	137 (90)	126 (83)	114 (75)
1931-32	109 (72)	108 (71)	108 (71)	110 (72)
1932-33	107 (70)	109 (72)	110 (72)	107 (70)
1933-34	102 (67)	103 (68)	100 (66)	95 (63)
1934-35	94 (62)	98 (65)	100 (66)	98 (65)
1935-36	100 (66)	102 (67)	104 (68)	102 (67)

CHART XIII.

WHOLESALE PRICE AND COST OF LIVING INDICES.



On the other hand, there was a definite downward trend in the Bombay Cost of Living Index Number, the lowest point having been reached in April, 1934, when it was only 93. The difficulty inherent in comparing monthly figures subject to large seasonal changes has been referred to in Lecture VII. In the case of the Bombay Cost of

Living Index Number this difficulty is aggravated because of the inclusion of foodstuffs which are marked by strong seasonal fluctuations.

Financial statistics.

As shown in Table No. 36 and Chart XIV, the active circulation of notes expanded by as much as 8 per cent., but clearing figures do not show any appreciable increase during the post-depression period.

TABLE 36.

NOTE CIRCULATION AND CLEARING FIGURES.

I.—ACTIVE NOTE CIRCULATION. (IN CRORES OF RUPEES.)

(Data from *Report of the Controller of Currency.*)

Year.	April-June.	July-September.	October-December	January-March.
Average for 1926-27 to 1928-29	162.3	153.0	165.9	173.3
1929-30	167.1 (102)*	157.1 (96)	164.2 (100)	163.6 (100)
1930-31	156.3 (96)	148.6 (91)	150.0 (92)	149.6 (91)
1931-32	142.9 (87)	139.1 (85)	159.6 (98)	168.9 (103)
1932-33	155.2 (95)	147.1 (90)	153.4 (94)	152.3 (93)
1933-34	159.1 (95)	152.8 (93)	158.4 (97)	163.5 (100)
1934-35	162.1 (99)	156.9 (96)	161.2 (99)	166.1 (102)
1935-36†	164.6 (101)	155.6 (95)	164.2 (101)	167.6 (103)

II.—UNADJUSTED CLEARING FIGURES. (IN CRORES OF RUPEES.)

(Data from *Monthly Survey of Business Conditions in India.*)

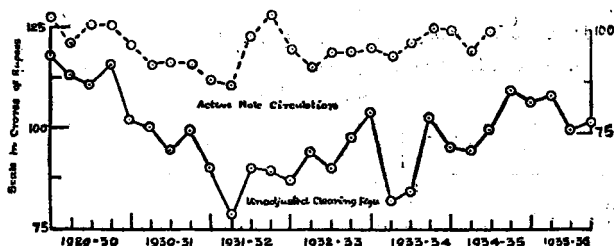
Year.	April-June.	July-September	October-December	January-March.
Average for 1926-27 to 1928-29	135.1	137.8	158.3	151.1
1929-30	171.1 (118)*	164.9 (113)	161.8 (111)	168.9 (116)
1930-31	149.3 (102)	146.0 (100)	137.1 (94)	144.4 (99)
1931-32	131.1 (90)	114.2 (78)	130.7 (90)	129.1 (89)
1932-33	127.2 (87)	137.5 (94)	131.9 (90)	142.9 (98)
1933-34	150.9 (104)	119.6 (82)	126.6 (87)	150.0 (103)
1934-35	138.9 (95)	136.5 (94)	145.1 (100)	160.1 (110)
1935-36	150.1 (107)	158.2 (109)	145.6 (100)	149.1 (102)

* Figures within brackets indicate the respective percentages, assuming that the average for the three years 1926-27 to 1928-29 was 100.

† The figures for 1935-36 are taken from the *Report on Currency and Finance* for the years 1935-36 and 1936-37, published by the Reserve Bank of India.

CHART XIV.

NOTE CIRCULATION AND CLEARING FIGURE.



It appears, however, from Table 37 and Chart XV that there has been substantial improvement in the prices of $3\frac{1}{2}$ per cent. Government paper, of non-speculative securities and of speculative securities, which show the nature of the recovery. The rise in the price of $3\frac{1}{2}$ per cent. paper is spectacular. It has reached a point which is far above the pre-depression level, even above the pre-war level. There is also a considerable improvement in the value of non-speculative shares. In fact this also is higher than the corresponding pre-depression figures. Speculative shares have also risen but have not yet attained the pre-depression level.

Trade figures.

It is evident also from Table 10, Section B, in Lecture III that our barter term of trade, both net and gross, which had declined with the onset of the depression, improved from 1933-34. Our quantum of export which had fallen by 25 per cent. in 1932-33 as compared with 1927-28 level, was only 12 per cent. less in 1935-36. The quantum of import which was 19 per cent. less in 1932-33 and declined further in 1933-34, started rising in 1934-35. In 1935-36 it was only 13 per cent. less than that of 1927-28. Our balance of trade in merchandise in 1935-36 was also larger in value than that of the previous year. But this export surplus was smaller than that of 1933-34 and was considerably below the pre-depression level. This will be clear from Table 38 given on page 132.

TABLE 37.

INDEX NUMBER OF GOVERNMENT SECURITIES AND
INDUSTRIAL SHARES.(Data from *Monthly Survey of Business Conditions in India*.)I.—INDEX NUMBER OF $3\frac{1}{2}$ PER CENT. GOVERNMENT PAPER.

(Base: July, 1914.)

Year.	April-June.	July-September.	October-December.	January-March.
Average for 1926-27 to 1928-29 }	80	79	79	79
1929-30	74 (94) ¹	71 (90)	71 (90)	68 (86)
1930-31	69 (87)	67 (85)	67 (85)	65 (82)
1931-32	64 (81)	61 (77)	55 (69)	59 (75)
1932-33	65 (82)	72 (91)	76 (96)	85 (108)
1933-34	88 (111)	88 (111)	86 (109)	89 (113)
1934-35	92 (116)	94 (119)	98 (124)	101 (128)
1935-36	97 (123)	96 (123)	98 (124)	101 (128)

II.—INDEX NUMBER OF NON-SPECULATIVE INDUSTRIAL SHARES.

(CHIEFLY PREFERENCE SHARES AND DEBENTURES).

(Base: July, 1914.)

Year.	April-June.	July-September.	October-December.	January-March.
Average for 1926-27 to 1928-29 }	108	111	111	112
1929-30	112 (101) ¹	110 (99)	109 (98)	100 (90)
1930-31	98 (88)	93 (84)	95 (86)	95 (86)
1931-32	93 (84)	90 (81)	86 (77)	87 (78)
1932-33	88 (79)	91 (82)	99 (89)	104 (94)
1933-34	108 (97)	110 (99)	110 (99)	111 (100)
1934-35	114 (103)	118 (106)	126 (114)	132 (119)
1935-36	130 (117)	130 (117)	129 (116)	133 (120)

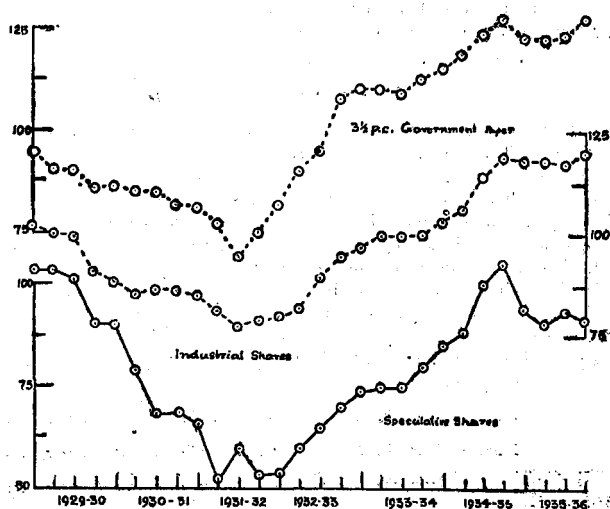
¹ Figures within brackets indicate the respective percentages, assuming that the average for the three years 1926-27 to 1928-29 was 100.

III.—INDEX NUMBER OF SPECULATIVE SHARES. (Base: July, 1914.)

Year.	April-June.	July-September.	October-December.	January-March.
Average for 1926-27 to 1928-29 }	229	232	235	247
1929-30	240 (103) ¹	240 (103)	236 (101)	210 (90)
1930-31	209 (90)	184 (79)	158 (68)	159 (69)
1931-32	154 (66)	121 (52)	140 (60)	124 (53)
1932-33	126 (54)	140 (60)	152 (65)	162 (70)
1933-34	173 (74)	175 (75)	174 (75)	186 (80)
1934-35	197 (85)	205 (88)	236 (101)	244 (105)
1935-36	218 (94)	211 (91)	218 (94)	215 (92)

CHART XV.

INDEX NUMBER OF GOVERNMENT SECURITIES AND INDUSTRIAL SHARES.



¹ Figures within brackets indicate the respective percentages, assuming that the average for the three years, 1926-27 to 1928-29 was 100.

TABLE 38.

INDIA'S BALANCE OF TRADE IN MERCHANDISE (PRIVATE).

+ indicates favourable balance; — indicates unfavourable balance.

(Data from *Annual Reports of the Controller of the Currency for India*.)

Year.	Balance of trade in merchandise (in crores of rupees.)	Year.	Balance of trade in merchandise (in crores of rupees).
Average of 5 years ending			
1913-14	+ 78.27	1931-32	+ 32.74 ^a
1927-28	+ 81.96	1932-33	— 12 ^a
1928-29	+ 86.47 ¹	1933-34	+ 33.02 ^a
1929-30	+ 78.98 ¹	1934-35	+ 19.31
1930-31	+ 62.05 ²	1935-36	+ 29.90 ^b

To sum up, there is no doubt that there has been practically an all-round improvement in the period under review especially after 1932-33. But the improvement has been lop-sided.

Extent of recovery.

It must also be remembered that some improvement indicated by the statistics in Table 37 is more apparent than real. For instance, the improvement in the price of speculative shares must be due to the inclusion of shares of protected industries, such as cotton and sugar. Similarly, the improvement in the price of Government securities is brought about by balancing the budget, by means of heavy taxation, both direct and indirect, and by rigid economies in public expenditure, which by their very nature can be only temporarily successful. The smaller improvement in the value of speculative shares as compared with that of non-speculative shares shows that there is even now business pessimism. In other words, the ravages of the depression have not yet been made good.

¹ Revised figures from the *Report of the Controller of the Currency for 1930-31*, p. 50.

² Revised figures from the *Report of the Controller of the Currency for 1932-33*, p. 47.

³ Revised figures from the *Report of the Controller of the Currency for 1933-34*, p. 51.

⁴ Revised figures from the *Report of the Controller of the Currency for 1934-35*, p. 41.

⁵ From the *Review of the Trade of India, 1935-36*.

Measures for recovery.

That there has been a recovery is an undoubted fact. The question now is, how did it come about? Was it a passive affair, India improving along with the rest of the world? Or was there any conscious effort for promoting recovery in India? It is therefore necessary to examine briefly the chief economic measures adopted in other countries for fighting the depression, with a view to secure trade revival, and to see how far they were applicable and were actually given effect to, in our country.

Monetary or non-monetary methods?

As has already been said in Lecture IV, it is not necessary to examine monetary and non-monetary measures separately, as most of the latter, though not monetary in origin, have some monetary effects. For example, tariff which is apparently a non-monetary measure, is closely inter-related to currency problems. Protective duties have often been imposed not merely for national industrial development but also for correcting temporary failures to balance international payments. Thus Keynes in his *Treatise on Money* advocated tariff for adjusting the foreign balance to foreign lending. In the Addendum to the *Report of the Committee on Finance and Industry* in England which was published some time after his *Treatise*, he proposed a scheme of tariff *plus* export bounty as an alternative to devaluation.

Protective tariff.

Let us therefore consider how far protective tariff is a remedy against trade depression. Its remedial power depends, as Hawtrey points out, on the amount of imports excluded by such measure. In India protection has been granted to quite a number of industries during the period of depression and after, the most important of which are cotton goods and sugar. It is true that the steel industry was the first to receive protection and that the output increased from 163,000 tons in 1923-24 to 630,000 tons in 1934-35, but our steel tariff dating from 1924, cannot evidently be called a depression or a recovery measure. It is similarly true that cotton yarn was protected as early as 1927, long before the beginning of the depression but protection to Indian cotton industry really began with the passing of the Cotton Textile Industry (Protection) Act of 1930. Sugar obtained protection in April, 1932 during the third phase of the depression. How far the production of cotton piece-goods and sugar has increased in recent years at the expense of imports from abroad, will appear from Table No. 39 given on the next page.

It will appear from the Table that while cotton mill production increased rapidly, partly under the stimulus of tariff, handloom indus-

try showed a relative decline during 1933-34 and 1934-35. The rapid increase in sugar production is noticeable. In fact, India is now practically self-sufficient as regards sugar supply,—as is apparent from the substantial decline in imports.

TABLE 39.
PRODUCTION AND IMPORT OF COTTON PIECEGOODS
AND SUGAR.

Data from *Bulletin No. 57 of Indian Industries and Labour and Annual Review of the Trade of India.*

Year.	Production of Sugar (from cane and gur) in thousands of tons	Import of sugar including molasses in thousands of tons.	Mill Production of Cotton Piecegoods in crores of yards.	Import of Cotton Piecegoods in crores of yards. (excluding fents)	Handloom Production in India in crores of yards.
1925-26	91	733	195	154	116
1926-27	121	827	226	177	133
1927-28	120	726	236	193	131
1928-29	99	869	189	190	108
1929-30	111	940	242	188	140
1930-31	152	901	256	88	139
1931-32	228	516	299	175	150
1932-33	370	369	317	119	170
1933-34	515	216	295	76	144
1934-35	617	323	340	94	146
1935-36	962	201	357	95	166

Its incidence.

It is therefore clear that it is possible to encourage the development of a particular industry by protective tariff. That does not however establish its efficacy as a remedy against depression, which is open to serious doubt for various reasons. Firstly, in a country like India, the burden of protection to manufacture, will be felt for years to come by agriculturists, who form the majority of the population of the country. We have already referred to the disparity between the prices of agricultural and manufactured products during the depression which has hit hard the agriculturist. He has to part with more of his goods, in order to obtain the same quantity of manufactured products. Protection cannot bridge this disparity, but only widens it.

Any benefit to agriculture?

It is true that so far as protection to sugar is concerned, the agriculturist is obtaining a higher price for his sugar-cane, but this is not the immediate result of the tariff but has been due to the passing of the Sugarcane Act of 1934, imposing a minimum price for cane.

Such a measure is not practicable in the case of raw cotton. In any case, a surplus has to be created artificially by a high protective duty or by an excise duty (when imports decline), and it is out of that surplus that a particular class of agriculturists growing sugar-cane or cotton can be paid, whereas the sacrifice due to the protective or excise duty has to be made by all agriculturists even though they receive no benefit, at least in the short period. For it is only in the long run that there may be some benefit to them due to an increased demand for food-stuffs and raw materials from industrial centres. We need not however go into that question here as we have to consider only the short period effects of tariffs for trade revival.

Agrarian protection.

Even if temporary protection during a period of depression is given to agriculture along with manufacture, as has been done in India in the case of wheat and broken rice,¹ its scope must be extremely limited, for it can be applied only in the case of those agricultural goods which are imported into India. There is a further condition. The decline in imports must stimulate production in India on a considerable scale. Even then, the benefit will accrue not to the whole body of agriculturists but to those alone, who are able to fill the void created by the exclusion of imports.

It is thus clear that protection at least in the short period can benefit only a small section of the community possibly at the expense of others and cannot therefore succeed as a measure of general trade revival. In any case it is essentially a policy of promoting revival in one country at the cost of intensifying depression in others. Thus while there was a phenomenal increase in the production of sugar in British India in 1933-34 as compared with the production in 1929-30, the output of sugar in Java, from which India received the bulk of her imported sugar in recent years, dropped to nearly one-fifth in 1933-34 as compared with the volume of production in 1929-30.²

Repercussions of tariff.

Moreover, the restriction of imports by means of tariff will mean in the near future, though not immediately, a restriction of exports also. Even admitting for the sake of argument that self-sufficiency should be our goal, the policy of making our country an oasis of prosperity in a desert of depression, by means of tariffs, is likely to be futile, as it would increase not only the difficulties of other countries but also of our own export industries. It is of course true that Keynes

¹ Protective import duty on wheat and wheat flour expired on the 31st March, 1937. The import duty on broken rice is to be continued till the 31st March, 1938.

² Article on "Sugar" in the *Economist*, (London) June 15, 1935, p. 1352.

has proposed bounty on export along with import tariff, to guard against this latter danger. But even if the financial difficulty of providing for the bounty is solved, such subsidy is likely to provoke the imposition of countervailing duty by foreigners and may give rise to the same difficulties as those of depreciating exchange which we now proceed to consider.

Implications of demand for a low rupee.

Why is this persistent cry in the country for lowering the value of the rupee as a measure for trade revival? What exactly are the implications of this demand for a "low rupee"? Do we really want "devaluation"? If so, in what sense? Strictly speaking, a devalued currency is one whose gold content has been reduced by a statutory authority, generally for stereotyping the depreciation which has already taken place. Do we want a gold parity for the rupee below what was fixed under the Currency Act of 1927? Or, is it a demand for a gold parity below that of 1913-14? Now-a-days it is usual to speak of devaluation in relation to pre-depression gold parity. But there is hardly any demand in India for devaluation in this sense. On the other hand, it seems to be agreed on all hands that the stabilisation of the rupee somewhere near its present gold value, when world conditions are so unstable will not be desirable. Thus the demand for devaluation in India must mean either the linking of the rupee with sterling at a rate lower than 1s. 6d., or it is a mere dodge for joining the race for exchange depreciation. The latter is obviously a demand for unregulated inflation which India, in view of her defective monetary organisation and weak position in export trade which will be discussed in the next lecture, is hardly competent to adopt. It is likely to cause a flight from the rupee and upset the whole mechanism for meeting our foreign obligations.

Is the rupee overvalued?

The demand for a lower parity in terms of sterling, would however be quite justifiable if the rupee was really an over-valued currency. This question has been recently considered by several economists and businessmen but their conclusions are different.¹ An apparently easy solution of this difference of opinion is to seek the assistance of the doctrine of purchasing power parity. But we pointed out in Lecture

¹ Most of the Indian economists and businessmen hold the view that the rupee is overvalued in relation to depreciated sterling. On the other hand, the opinion of an authoritative publication of the League of Nations (*Commercial Banks*, 1929-1934, p. lxxiv, Introduction) is that the rupee was undervalued both in relation to British sterling and French franc during the years 1931-1934. It may be noted in this connection that in spite of the so-called "strangling of our export trade due to the overvaluation of the rupee in terms of sterling," the value of our export of merchandise to the United Kingdom rose by the same percentage as our import from that country between the years 1931-32 and 1935-36.

V that for calculating this parity we should consider not wholesale prices but consumption standard, or rather the closest approximation available, *viz.*, the cost of living index number. It was also made clear that this could give us valid results if the barter term of trade did not change in the meantime. No formula has yet been discovered for determining the normal rate of exchange in view of changes in the barter terms of trade. Keynes points out in his *Treatise on Money* that "there is no justification, even in the long run, for any precise, necessary or immediate relationship between changes in the rate of exchange of the currencies of two countries and the changes in their consumption standards relatively to one another. To suppose that there is overlooks the possibility of a change in the Terms of Trade."¹ It is apparent from Table 10 that our term of trade, whether on 1913-14 basis or on 1927-28 basis, has considerably changed during the years of depression and recovery, making any facile application of the purchasing power parity out of the question.

The fact of the matter is that we cannot determine the "normal" exchange rate on the basis of prices which purchasing power parity evidently implies, unless prices have established themselves and the exchange rate and prices have mutually acted and reacted upon each other, during the period in question.

In the second place, our quest for a normal rate of exchange must be futile, until prices have adjusted themselves substantially to costs both at home and abroad, and there is no pressure on the exchange rate in order to meet foreign obligations. If these conditions are not fulfilled, it is idle to calculate purchasing power parities and to argue on that basis in favour of either a higher or a lower rate of exchange.

Sir George Schuster's views.

On the other hand, the arguments adduced by Sir George Schuster against the proposal for reducing the value of the rupee in the course of his budget speech on February 27, 1934, do not appear to be quite convincing. He gave two reasons. The first was that it would not solve the disparity between agricultural and manufacturing prices which was one of the main maladjustments during the depression. The second was that the mere raising of rupee prices would not stimulate the demand for such products in foreign markets.

Are they valid?

Sir George does not however explain why these should be so. For it is difficult to say without further analysis whether the disparity between agricultural and manufacturing prices would remain the same or it will become greater or less as a result of devaluation. The fact

¹ Keynes—*A Treatise on Money*, Vol. I, p. 73.

is that the effect of devaluation on prices is somewhat obscure and is not necessarily the same in every case. Important factors to be considered are the elasticities of demand for exports and imports of the country which has devalued its currency, the percentage which the country's foreign trade bears to world trade and to its own total trade (domestic and foreign), deflation in gold standard countries and the imposition of special measures against exchange-dumping. A widely accepted view is that the effect of currency depreciation is on the whole deflationary on the gold price level rather than inflationary on the domestic price level. Thus the general effect in sterling countries of abandoning old gold parities has been to raise the wholesale prices only to a moderate extent, while maintaining the cost of living at approximately the same level. It is well known that the depreciation of sterling did accelerate the fall in gold prices. As pointed out in a recent report of the Royal Institute of International Affairs, "over a considerable range of commodities it was gold prices rather than sterling prices that had to adjust themselves to the reduced exchange value of pound. When in addition there is brought into account the part which the fall of the pound undoubtedly played in inducing abnormal trade restrictions and thus in affecting adversely the bulk of international trade, the contribution which it made to the lowering of gold prices can hardly be dismissed as of secondary consequence."¹ But unlike sterling, the rupee is not important enough² to dominate the course of world prices. Its devaluation therefore is not likely to have any deflationary effect, either on sterling or on gold prices. It may therefore be argued that while we shall have higher rupee prices³ for our exports as a result of devaluation, we might expect to receive at least the same gold prices as before. If this is so, it may be possible for us to stimulate our exports by selling them at a lower gold price than formerly while obtaining more or less the same rupee price.

Lag between costs and prices.

It may be further argued that the cost of production in India is not likely to rise appreciably along with the fall in exchange so as to neutralise the gain from export trade. Assuming that the cost of living index is an approximate measure of labour costs, it may be pointed out that the experience of Australia and South Africa was that devaluation was not immediately followed by a rise in the cost of living.

¹ *The Future of Monetary Policy* by the Royal Institute of International Affairs, p. 30.

² Apart from the overwhelming superiority of sterling in world's finance, even in the sphere of commerce the share of the United Kingdom was as high as 13·93 per cent. of the world trade in merchandise, but that of India was only 2·71 per cent. in 1935. (*Review of World Trade*, 1935, p. 25.)

³ But if the foreign demand for our exports is inelastic while the domestic demand for such exportable goods is elastic, the rise in the rupee price of our exports will be quite small.

We may also expect the same thing to happen in India. The reason is that our foreign trade forms such a small proportion of our total trade that it is unlikely that Indian prices and costs in general, will rise *pari passu* with the depreciation of exchange. From this it does not however follow that Indian exporters will go on obtaining higher profit in terms of rupees for any appreciable length of time.

Real drawbacks of devaluation.

In fact the chief objections to devaluation as a measure for our trade revival are as follows. In the first place, during the period of the depression about one-half of our exports, consisting of raw materials for industries (see Table 40 in Lecture X) had an inelastic demand in foreign markets. Marshall has no doubt said that "the demand for imports by an energetic industrial country will generally be elastic."¹ From this it would appear that the foreign demand for our exports, the great bulk of which go to industrial countries, would normally be elastic. But when the depression was acute and entrepreneurs in industrial countries were faced with dwindling or negative profits, they were not likely to be tempted to buy more of our raw materials even if they were available at a lower price in terms of their own currency. When trade revival has already set in, the stimulation of such exports by devaluation is unnecessary. It may, on the other hand, cause a set-back in trade by provoking the imposition of hostile tariffs. With regard to articles of food and drink which form about 20 per cent. of Indian exports, foreign demand is generally inelastic. It is true that this inelasticity of demand might have become less on account of the fall of income in foreign countries during the depression. But the devaluation of the rupee was not likely to cause any appreciable extension of demand even for such exports because most of our customers abroad had adopted a policy of agricultural protectionism for their own countries.

Two meanings of elasticity of demand.

But it may be argued that we are confusing elasticity of demand for total exports with the elasticity of demand for a particular commodity. As Prof. White² has pointed out, while the elasticity of foreign demand for a particular commodity or commodities may be less than unity, the demand for total exports, potential as well as actual, is likely to be elastic because the line of comparative advantage for any country is a moving line and a fall in prices (in terms of foreign currency) may cause some goods which formerly did not figure as exports, to be included in the list of exports. This may be true in the case of countries

¹ Marshall—*Money, Credit and Commerce*, p. 172.

² *The Quarterly Journal of Economics*, Vol. 48, p. 734.

exporting manufactured goods. But Indian agriculture lacks diversification to such an extent that it will be difficult for us, at least in the short period, to substitute new articles of export in the place of the limited number of exports which we now have. Thus the attempt to stimulate Indian exports by a further depreciation of the rupee during the period of the depression would most probably have caused their total value to fall in terms of sterling or of gold, in spite of the increase of their volume.

Special feature of manufactured goods.

It is well to keep in mind the remarks in the *Review of World Trade*, 1934, published by the League of Nations, that "the effect of currency depreciation upon exports is most clear in the case of manufactured articles". According to this report, the stimulus to export in such cases comes from the reduction in terms of gold in the cost of manufacture which contains several elements that cannot be easily reduced in terms of the national currency. But it appears that there is an additional reason, *viz.*, that the foreign demand for such manufactures is generally elastic. It was therefore possible for England to stimulate its export trade by accepting lower gold prices but this was hardly possible in the case of the majority of our exports during the period of the depression.

Anti-dumping duties.

Secondly, there was the danger that our exports might have been penalised by foreigners by the levy of anti-dumping duties. As Prof. Gregory points out, "in actual fact, the process of exchange depreciation is not allowed to work itself out without let or hindrance. The effect of competitive exchange depreciation being temporarily to stimulate exports from the countries that first depreciate their exchanges, other countries retaliate, not merely by lowering their exchange rates, but also by increasing the restrictions they impose upon foreign trade generally. If country *B*, for example raises its tariff in proportion to the fall of *A*'s exchange, producers in *A* stand to gain nothing; if by more than this, they will actually lose."¹

That the fear of retaliation in our case is not groundless, will be clear from the immediate repercussion of devaluation by New Zealand. In the words of the *World Economic Survey*, 1932-33, "within a few days (of this devaluation), Denmark, the chief rival of New Zealand in the English butter market, allowed the krone to drop approximately

¹ Prof. T. E. Gregory's Comments on new technical arguments for postponing stabilization in the *Improvement of Commercial Relations between Nations: The Problem of Monetary Stabilization* (International Chamber of Commerce, Paris, 1936.)

to the same level. Shortly afterwards, the Canadian Government initiated friendly conversations with New Zealand in order to avoid the necessity of imposing exchange dumping duties. However, the price of butter in London went down substantially, and the advantage accruing to the New Zealand exporter was minimised, with a more permanent possibility of his markets being restricted". Thus exchange depreciation "tends to have a boomerang effect", returning to strike at the spot from where it started.

Secret of Japan's success.

But a champion of devaluation may refer to the phenomenal industrial progress of Japan which followed a policy of exchange depreciation mainly during the years 1932 and 1933, for the yen showed stability in relation to gold from October, 1934, to the end of the period of our study. It appears that during the first eight months of 1933, when Japan's exchange depreciation was very appreciable, her export of cotton piece-goods exceeded in quantity the foreign sales of Lancashire. This was partly due to the rapid fall in the value of yen with the retention of pre-depreciation wage-rates. As Hubbard writes, "when the yen outdistanced the fall in gold prices with the result that the wholesale price index recorded a substantial advance, food prices did not as a whole share in the general rise, and the cost of living as far as wage-earners were concerned remained comparatively stable". The accumulation of stocks of imported raw cotton in excess of their immediate requirements by the Japanese merchants before the policy of exchange depreciation had been adopted, also helped the rapid increase of Japan's export. But a more fundamental reason was the remarkable efficiency of her industrial organization.

The following extract from the weekly notes of the *Economist* (London) of December 16, 1933, will fully support our contention:—

"Japan's success in the world's markets during the last two years has been due to three main factors: efficiency of industrial technique and organisation; low costs due to deflation while the gold standard was still in force; and high prices due to the inflation following its abandonment. the almost unanimous response of European and Indian manufacturers has been to raise a loud and querulous chorus for more and yet more tariffs against Japan. Japan threatens retaliatory tariffs on her competitors' goods. Indeed, the whole story of the depreciated yen is an impressive warning of the dangers of fluctuating exchanges. The successive moves in the game and the inevitable stalemate in the end are now painfully familiar to us all: exchange depreciation; export bounty; 'anti-dumping' duties abroad; retaliatory duties at home; quotas, prohibitions and subsidies; and finally, to the perfect content of all protectionists' hearts, trade 'balanced' at zero".

Adjustment of internal cost to internal price level.

Had devaluation secured mere export advantage at the expense of other countries, recovery in one country with depreciating exchange would have been neutralised by intensified depression in others. In fact the efficacy of devaluation as a recovery measure lies mainly in the re-adjustment it may bring about between internal costs and prices. It may however be pointed out that the present state of statistical knowledge about the different cost structures in India and the extent of the devaluation required, 'is so meagre and imperfect that an attempt to bring about an adjustment between costs and prices through exchange depreciation, might lead not so much to trade recovery as to increase in trade restrictions, making it more difficult for us to meet our foreign obligations.

It should not be forgotten that the extent of exchange depreciation and the rise of internal prices are by no means proportional. While the extent of depreciation in the case of Great Britain from September, 1931 to April, 1934 was 37·7 per cent., the net increase in wholesale prices during the period was only 4 per cent. In the U.S.A., on the other hand, the extent of devaluation between June, 1933 and April, 1934 was 40·5 per cent. but wholesale price index recorded an increase of only 13 per cent. In the case of Japan however the extent of depreciation between November, 1931 and April, 1934 was as high as 64·2 per cent. but the net increase of price during the period was only 20·7 per cent.¹ In any case, it is certain that the reduction of our exchange rate to 1s. 4d. sterling which has found so many advocates in India, is not likely to bring about any appreciable rise of rupee prices and any adjustment worth the name between costs and prices in India.

Experience of Australia.

But it may be asked—Did not Australia, a country exporting primary products like India, stimulate trade revival by exchange depreciation? The truth is that Australia's recovery was due not only to currency depreciation but also to cost reduction. In Prof. Copland's view, the improvement in the Australian position was due "equally on the measures of deflation and those of inflation". The chief inflationary measure was currency depreciation. Of the deflationary measures, the most important was the reduction in wages and in the salaries of public servants. The reduction in nominal wages during the depression amounted to as much as 26 per cent. This wages reduction gave rise to controversial issues. On the one hand, it was argued that wage reduction was foolish in times of depression because it reduced the

¹ Hubbard—*Eastern Industrialization and Its Effect on the West*, p. 96.

spending power of the community. On the other hand, it was contended that disparity between prices and costs was so great that a reduction of wages, by reducing costs, would increase the chance of profitable enterprise so as to lessen unemployment. Such controversy is by no means confined only to Australia. Thus Mr. Butler, Director of the International Labour Office, in his annual report of the 19th session observes that reductions in wages have nowhere succeeded in reducing costs without causing a further fall in purchasing power and prices. On the other hand, Hawtrey writes, "a relatively moderate reduction of wages may bring a very substantial increase in productive activity, *provided* a similar reduction of wages does not occur in other countries. In fact when one country lowers wages relatively to others, it gains a competitive advantage and shifts part of the burden of depression from its shoulders to theirs". The Australian economists took up a middle position between these two views. They advocated wage reduction as a method of reducing costs, but at the same time adopted other measures, *e.g.*, currency depreciation which made large wage reductions unnecessary. The truth is that wage reduction as a recovery measure cannot succeed in all phases of the depression. For example, when depression is very acute with falling prices and there is a general lack of confidence among entrepreneurs wage reduction cannot tempt them to resume business activity. Reduction of wages on such occasions does not remedy but simply aggravates the disease by causing further fall in prices.

When should wages be reduced?

Wage reductions if it is to succeed as a recovery measure, must be moderate and must be confined to a particular country. Above all, it should be applied only in that stage when the bottom of the depression has already been reached so that a small stimulus in the shape of wage reduction facilitates revival. On such occasions, a reduction in the wage rate will not, on the whole, cause any decline in consumers' spending power but simply transfer that spending power to employers who will utilise it, partly in employing other kinds of labour, partly in purchasing consumption goods and services and partly in buying capital goods. All this will ultimately lead to the increase of purchasing power in the hands of the community. Similarly increased wage rates may under certain conditions retard industrial recovery by raising costs and reducing profits but they may promote recovery when the prospects of a larger *amount* of profits due to increased sales are so bright that even the risk of some reduction in the *rate* of profits, will not lead entrepreneurs to curtail their production. The question whether reduction or increase in the wage rates should be applied as a recovery measure depends therefore on suitable psychological condition during the course and phases of a depression.

Is reduction feasible everywhere?

But the policy of a *direct* reduction in wage rates as a recovery measure is possible only in countries like Australia where there is wage-fixing State machinery. Before the depression, the general impression was that wage rates in Australia were very rigid or rather they had one-sided elasticity, *i.e.*, an increase in wage rates through the Arbitration Court was quite easy in an era of rising prices. The general impression was that the Australian labourer would fight tooth and nail against any reduction in wage rates under falling prices. But when the depression actually set in, the world was surprised to find a flexibility in Australia's apparently rigid wages structure. A *direct* cut of twenty-six per cent. in nominal wages was impossible in any other Western country. A far smaller reduction would have provoked the gravest industrial conflict in such countries. For them the only practicable method of wage reduction was an indirect one through currency depreciation or devaluation.

Difficulties in the case of India.

In India, wage reduction as a method of trade revival, is wholly impracticable. It is true that the supplementary budget of the Government of India in September, 1931, imposed a 10 per cent. cut in the salary of all its servants, high and low. This was applied in the case of their own servants by all provincial governments and even by some local bodies. Moreover this cut was imposed in that stage of the depression when cost reduction was likely to prove efficacious, for by October, 1931, the worst phase of the depression in India was over and prices then were tending to look up. Yet this emergency cut had hardly any stimulating effect on trade, for it could not bring with it any reduction in the wage rate, either industrial or agricultural.

Though trade unionism in India is very weak, any direct cut in the wages of industrial labour is likely to give rise to strikes and labour unrest which would not be conducive to a trade revival. Even if such wage-reduction in industries is possible, it would not stimulate agriculture, the major industry in the country. But can we not reduce money wages in agriculture? This is neither practicable nor desirable. As is well-known, our agriculture has not yet been organised on a capitalistic basis. The Indian farmer is very often entrepreneur and labourer, all combined in one. Hence the reduction of agricultural wages cannot be expected to have any stimulating effect on agriculture. Moreover wide variation in agricultural conditions even in the different parts of the same province and the absence of any machinery for fixing wage rates, make cost reduction through emergency cuts in wages, wholly impracticable. The difficulties in the fixation of minimum wages for industrial labour, referred

to by the Royal Commission on Labour, apply with much greater force in the case of agricultural wages. The Australian method of exchange depreciation *plus* cost reduction is thus inapplicable to India.

Reduction in interest rate.

But can we not promote agricultural revival by cost reduction in the form of interest charges? This has been adopted more as a relief measure for the indebted agriculturist than as a method for promoting trade revival, not only in some of the Indian provinces and States but also in several other agricultural countries of the world. "Swat the creditor" seems to be the underlying note of most of the recent debt relief legislation in India.¹ Compulsory debt reduction—euphemistically called 'conciliation'—has too often been rammed down the throat of the creditor who is the underdog at the present time. But champions of debtors who are anxious to benefit them at the expense of creditors, should remember that "while an old creditor is a nuisance, a new lender may be a timely help and the new lenders will take note of the treatment meted out to the old".

Fixing a maximum rate.

If agriculture is as much an industry as manufacture and cannot do without credit, any legislation, however well-meaning, will fail as a recovery measure, if it shakes the foundation of rural credit. Thus the attempt to provide cheap credit for the ryot, by fixing a maximum rate of interest much lower than the usual rate prevalent in the mofussil, is bound to fail, if the risk borne by the creditor is not simultaneously reduced.

The following remarks by the Shillong correspondent of the *Statesman*, on the 24th of January, 1937, will fully bear out this contention:—

"The Assam Money-lenders Act—passed with a view to give relief to debtors—has resulted in a restriction of credit in the country districts, to the detriment of agriculturists. Money-lenders are now no longer giving loans because it is difficult to realize them again". In fact, the general effect of most of the recent debt relief measures has been to increase the dearth of money in rural areas where money was already far from sufficient.

¹ Excepting perhaps the solitary instance of debt redemption in Bhavnagar State, we search in vain among recent debt relief schemes in this country, for any provision of cash by the governments of Indian provinces and States, for composition with creditors. Such a provision would, apart from the relief to debtors, have facilitated agricultural revival by injecting more money into rural areas. It is interesting to note that in March, 1935 the Commonwealth Government of Australia "passed an Act providing for the distribution of £12,000,000 amongst the States for the purpose of facilitating the adjustment of farmers' debts by means of direct cash payments to creditors, if necessary". (*The Economic Record*, December, 1936, p. 273.)

Cheap money at headquarters.

Thus quite a paradoxical situation has arisen in India since the middle of 1932. There has been a plethora of liquid funds in the organised money markets of India, as indicated by the rise in the price of Government securities, the fall in the bank rate and the increase of bank deposits while our rural areas are suffering from a chronic dearth of money.

To what extent has this cheap money facilitated trade revival in India? So far its beneficent effect is visible mainly in two directions:—

(1) the growth of building activity in Calcutta and some other industrial cities; and

(2) the reduction of State expenditure by enabling the Government, both central and provincial, to borrow at much lower rates of interest and to reduce the burden of public debt by conversion schemes.

But beyond this, it has done little so far to contribute towards industrial recovery.

It may however be pointed out that the role of cheap money is mainly confined to removing obstacles to trade revival, rather than creating actual recovery. A stringency of money no doubt retards industrial recovery. But the mere fact that a business man can borrow at a cheap rate, does not induce him to borrow, unless he is assured of profit.

Public works.

Why not utilise this idle money for financing public works by the State? This is the reason why economists of the reflationist school have demanded public works financed by public loans along with a policy of cheap money, as a recovery measure. Sir George Schuster in his budget speech on February 27, 1934, admitted that public works expenditure might prove useful when the depression was just being replaced by recovery. Mr. A. D. Gayer in his article on "Public Works as a Recovery Expedient" in *Index* (Stockholm) for May, 1936 also refers to the problem of correct timing as of crucial importance. It is true that the nature and course of the trade cycle are so obscure and imperfectly known that it is difficult to find out exactly when the crisis has been passed and only a stimulus in the shape of public works is necessary to re-establish business confidence and to start recovery. On the one hand, if public works expenditure is begun too early, it may not produce any results, unless it is on such a lavish scale that prices respond in spite of the depression,—which of course is out of the question in the case of India. On the other hand, if it is begun too late, it may seriously compete with private industrial undertakings,

still suffering from the after-effect of the depression. If the above analysis is correct, public works should not have been started before December, 1932. The question is, has the time now passed for such a measure? It depends on whether Government borrowing will force up long-term rates of interest so much as to make industrial investment unremunerative. From Table 37 it is apparent that even as late as March, 1936, while the value of Government securities was 28 per cent. above the pre-depression level, the value of non-speculative industrial shares had risen by some 20 per cent. but the value of speculative shares was still 8 per cent. below the pre-depression level. It is therefore evident that public works programme financed by loans was not too late even in March, 1936.

Items to be taken up.

Another condition for the success of such a programme was laid down by the Hon'ble Sir P. James Grigg in his budget speech on February 28, 1936 in the following words:—"It is contrary to strict financial orthodoxy to borrow for expenditure which does not yield a cash return equivalent to the interest and sinking fund charges on the amount borrowed". The question is, when is this cash return to be expected? Is it to be expected as soon as the first clod of earth is turned for building a road or making a canal? Or, are we to consider the return averaged for the period of the currency of the loan? In any case, it is necessary to enlarge our views and consider returns other than immediate cash returns. We should remember the following wise words in the *Future of Monetary Policy* by Royal Institute of International Affairs (p. 85): "We may consider capital works not profitable in the narrower sense, but profitable to the community at large. A new road or a new bridge may more than pay for itself: for example, if it creates new rateable values and increases the value of neighbouring property or if it increases the profits and taxable capacity of those who make use of it. If a bridge saves a long detour, the transport cost of those who use it may be substantially reduced. Similar considerations would apply to a new water supply system or any facility of a similar sort". In India there are many avenues for such useful expenditure. For instance, wells in rural areas for supplying drinking water may not yield any immediate cash return but may be otherwise useful in combating preventable diseases and increasing economic efficiency and welfare.

Nor is the criterion for testing the economic justification of any item of public works vague and otherwise unsatisfactory in India. For a famine, which is merely another name for agricultural unemployment on a large scale, nature having declared a lock-out,—we have an elaborate machinery for financing and carrying on enterprises, which

have justified themselves irrespective of their immediate cash returns. The Royal Commission on Labour in India similarly recommended an energetic programme of slum clearance, and the construction of roads and drainage during industrial unemployment, which must promote lasting benefit to the community.

The pace of expenditure.

It now remains for us to consider the pace of the public works expenditure. It has already been pointed out that any lavish scale on the American model is beyond the capacity of India. On the other hand, Mr. Gayer in his *Monetary Policy and Economic Stabilisation* has suggested flexible public works for economic stabilisation, "operations being timed to fluctuate inversely with general cyclical movements of business, that is, retarded in times of prosperity and speeded up in times of industrial stagnation". This will prevent competition of public works with private enterprises. But there is such a crying need in India for ameliorative public works relating to sanitation, public health and water supply that such alternate expansion and contraction of public works may not always be desirable. For example, the construction of hospitals or irrigation canals began during a slump, should not be stopped simply because a boom in trade has arisen.

On the other hand, there is something to be said in favour of carrying on public works only during the off-season when there is no demand for agricultural labour in rural areas. It is evident that when roads or bridges or canals are constructed on such a heavy scale that there is a shortage of agricultural labour or a rise in its wages, the production of crops such as jute, so far as it is carried on with hired labour, is likely to become costly while the price of such crops which depends mainly on foreign demand, is not likely to increase. The position of cultivators of these crops is therefore likely to change for the worse, as a result of public works programme carried on during the agricultural season.

Other difficulties.

There are similarly other points which merit special consideration in India. In the first place, we have no unemployment insurance and can therefore have no relief to our finance through increased employment whereas other countries while spending more for increased employment saves also more through diminished unemployment. There is also the difficulty inherent in public works programme in all countries which is specially acute in India. For, if such a programme is to be successful, it must result in a rise of prices and in a corresponding fall in the exchange unless other countries raise their price levels simultaneously and to the same extent. It is idle to expect this in the pre-

sent stage of international co-operation. We have therefore to sacrifice stability of exchange for the sake of increasing prices. This is exceedingly difficult for a debtor country like India with large external obligations. But it should not be impossible to provide more employment and additional purchasing power in the hands of consumers without unduly affecting the price level and the exchange rate. During famines, the exchange becomes unfavourable not because of public works but because the export surplus is scanty, or because instead of a favourable balance of trade, we have an adverse balance.

To sum up, it seems that Government have been unduly cautious with regard to public works expenditure. Some part at least of the hardship and suffering of the depression could have been mitigated by expenditure on beneficial projects, even though they could not be immediately paying propositions.

Non possumus attitude of Government.

From the above description it is clear that Government of India's policy whether during the depression or the recovery was one of *non possumus*. Not that, nothing was done, but everything was done passively. The public works expenditure came as a sequel to earthquakes in Beluchistan and Bihar. The regime of cheap money was inaugurated because of low rates of interest in the London money market. The reduction in the salary of public officials was called for by a similar reduction in other countries. One looks in vain for a well thought-out independent way out of the trade depression. There were other measures such as restriction of acreage under jute, of output of tea and of rubber. The last two are international measures, whereas the first is halting and half-hearted. Restriction of jute, if it is to be successful, calls for the necessary machinery and also a surplus out of which the cultivator of jute has to be remunerated for the loss incurred by him, either because he keeps his jute land fallow or because he does not get as much from substitute crops as he used to get from jute. In conclusion, it is useful to recall the following words of Keynes in his *Means to Prosperity*, (p. 17) :—

“As an all-round remedy, restriction is worse than useless. For the community as a whole it reduces demand, by destroying the income of the retrenched producers, just as much as it reduces supply. So far from being a means to diminish unemployment, it is, rather, a method of distributing more evenly what unemployment there is, at the cost of somewhat increasing it.”

LECTURE X.

CONCLUDING REMARKS.

The survey of Indian currency during the last decade reveals unmistakably one patent fact that our currency authorities have generally played more or less a passive role in the working of the highly complex monetary machine which now so much controls the economic life of different nations. Various attempts were made in other countries to remedy the depression, which, next to the war of 1914-1918, was the greatest malady that the world suffered from, during the last hundred years. Not even the worst critic of the Government of India can accuse it of over-doctoring with regard to this disease. But in passing judgment on the currency administration in India in recent years, we should first of all ascertain what should be the objective of our currency policy in the near future and also in the long run. In the next place, we should consider whether we have adequate machinery for attaining that objective. For it stands to reason that we should not blame Government for not doing something which it never thought of attempting. Nor is there any reason for complaint if the necessary machinery were wanting. Finally, we should try to find out, if possible, the practicable lines of reform so as to enable our financial machinery to produce the desired results.

Objectives of central banking.

At the outset, we have to recognise the considerable changes in the duties and responsibilities of currency authorities during the last hundred years. Currency management generally means control by the central bank. In the earliest stage of central banking, convertibility of notes, or what came to the same thing, stability of exchange was regarded as the sole objective. As time went on, a new function was added, *vis.*, management of financial crises. Gradually, and almost imperceptibly, stability of price level was regarded as a desirable objective. The point however was not made clear what particular price level was to be stabilised,—Consumption Standard or Earnings Standard. Even with this refinement the objective came to be discarded, when it was found that stability of prices did not necessarily mean stability of profits or of employment.

How far can unemployment be prevented?

A further refinement is necessary. Unemployment may be divided into three categories.¹ Thus we have to consider in the first place "normal" or frictional unemployment which would exist even in prosperous periods, "owing to seasonal changes, the movement of labour from one job to another, and the existence of unemployables". In the second place, we may have "special" unemployment "due to peculiar causes such as a collapse in the demand for a particular group of commodities, so sudden that the labour cannot be transferred to other trades in a reasonably short time". Lastly, there may be "cyclical" unemployment due to fluctuations in industrial activity which does not proceed evenly. If this analysis is correct, it should be no business of a central bank to try, to cure the first type of unemployment, which can be prevented, if at all, through inflation. The second also is clearly outside the scope of central banking. Marshall quite rightly pointed out long ago, "There are some causes of discontinuity of labour which we cannot remedy such as bad harvests, and some which we should not wish to remedy, such as new inventions". Thus it is the third kind of unemployment alone which should be the concern of currency and credit authorities.

Stability in real income.

On a closer examination, certain difficulties appear even with regard to such narrowed duty and responsibility. It is common knowledge that during the last three or four years cyclical unemployment in Germany has been considerably reduced by an expansion of credit which has been utilised in manufacturing armaments and in constructing roads. The supply of consumers' goods has however been rigidly kept down partly through shutting out of imports and partly through restriction on plants at home for the production of consumers' goods. Thus there has been merely a disguised transfer from those formerly employed to those formerly unemployed through rising prices. There has been no increase in the community's real income. In other words, full employment must not be secured by sacrificing real income of the community. If there is a higher average real income than before and also a better distribution, then there is no question that there has been economic progress and greater economic welfare. If a central bank has been able to achieve that, it may be said to have been successful. In other words, stability of incomes is put forward as a second possible aim of currency administration. It is, however, an open question, how far, if at all, a central bank is able to discharge this duty. We shall revert to this problem later on when we shall examine the adequacy of financial machinery.

¹ *The Economist* (London) April 4, 1936.

Stability of output.

In view of such difficulties, a more modest, or rather an apparently more modest objective has been suggested by some writers.¹ According to them the aim should be stability of output through adjustment between cost and prices brought about by monetary means. The question as put by Prof. Gregory² is: "Should an attempt be made to adjust *costs* to the price level, or the price level to the costs"? The former cannot be attempted by a central bank except in an indirect manner through manipulation of the short-term and long-term rates of interest. But the chief method of reducing costs, *viz.*, reduction of wages, is outside its scope and is in any case difficult because of organised trade unions and other causes of economic friction. The burden of the existing debt is also easier to be mitigated by a rise in prices rather than by any scaling down of the principal or the interest.

Difficulties in an open system.

It should be remembered, however, that the adjustment of prices to costs can bring about stability of profits and of employment, only in a closed system. To the extent a country is dependent on foreign markets for the disposal of her products, she must adjust her prices not only to her own costs but also to the prices in the competing countries. This difficulty is intensified in the case of a debtor country, which must have an export surplus for meeting her foreign obligations.

Ability to produce.

*Considerations such as these have led to the suggestion for a fourth objective for a central bank, *viz.*, ability to produce. Thus it has been said "if factories that could be used to produce things that people need are idle, and workmen who could work there are without jobs, that is a clear sign that there is too little money in circulation". This sounds very much like the objective first discussed, *viz.*, full employment, and also like the one discussed subsequently, *viz.*, the criterion of real income in the shape of consumable goods. It will also be apparent that production can proceed only if prices and costs are at a parity. Why then are such rival aims proposed for a central bank, seeing that they all practically come to the same thing? The fact is, that in an equilibrium period, all these different *desiderata* are simultaneously achieved. It is only during a period of disequilibrium that we have to consider one in preference to another as needing attention from currency authorities. At the same time, it is necessary to realise that planned money by itself cannot influence economic life to the desired extent and within the desired

¹ *Monetary Policy and the Depression* by the Royal Institute of International Affairs, p. 35.

² *Fortnightly Review*, September 1931, p. 292.

period, unless its efforts are supplemented with other measures. In other words, "in default of a planned system of production and distribution, the planning of money alone is bound to be defective". This point will be discussed subsequently when we consider the adequacy of financial machinery of a country.

Exchange stability *versus* internal price stability.

It has already been pointed out that the earliest function of a central bank was exchange stability. But it has not yet become out of date. As late as 1934, there was a full dress debate on Exchange Stability *versus* Internal Price Stability in the Royal Statistical Society initiated by Prof. Jones and carried on by Mr. Hawtrey, Sir Basil Blackett, Sir Josiah Stamp and others. It was agreed on all hands that it was neither desirable nor possible to have exchange stability in the pre-war sense of a rigidly fixed gold equivalent for the currency, varying only within narrow specie points. Prof. Jones did not describe in detail the methods necessary for controlling gold so as to enable it to function as a safe and satisfactory international measure for value. Mr. Hawtrey also did not explain clearly what exactly he meant by internal price stability beyond saying that "he believed not in a mechanical stabilisation of the index number but in a stabilisation which makes due allowance for changes in real costs". In any case, it is best to argue not on the basis of abstract principles but on the basis of facts actually obtaining in India in order to find out what should be the objective of Indian currency administration. For it stands to reason, that the currency system of any country must be adapted to her special needs and must fit in with her present economic structure both internally and in relation to the external world.

What can the Reserve Bank really do?

To take up the question of full employment first, what can the Reserve Bank really do? There is seasonal unemployment which is inherent in agriculture. Even with the antiquated methods of production calling for more men than modern capitalistic farming, there is a great pressure on land in considerable parts of India. To describe the first as "normal" unemployment and to regard it as outside the scope of central banking is easy. But it is not so easy to describe the second as "special" unemployment, and therefore not within the purview of central banking. Overpopulation, if there has been any, has not been sudden. The loss of balance between agriculture and manufacture, throwing more people on agriculture than is either necessary or desirable did not occur overnight. On the other hand, it is easy to see that it is beyond the power of the Reserve Bank to open up new areas for cultivation, or to control the birth rate, or to start industries to redress the existing disequilibrium. On the other hand, if the Reserve Bank is successful

in curing "cyclic" unemployment, it will not achieve much. For unlike advanced western countries, the disparity between prices and costs in manufacturing industries does not affect our economic life so profoundly that its removal will appreciably relieve the situation. On the other hand, agricultural cycles due to the vagaries of the monsoon and the conditions of production and consumption in the external world cannot be readily tackled by purely monetary means. It is only after our economy approaches the western type that we can think of full employment as a desirable objective of currency administration. Similar remarks also apply to stabilisation of incomes, the factors governing which are so complicated that the currency authority can only transfer incomes from one class to another class but cannot add to the aggregate income of the community as a whole, except only to a very limited extent. It is true that our economic policy would be directed towards higher real incomes, in the form of a larger output of consumption goods, better distributed among the different sections of the people. It is equally true that our currency policy as an integral part of the economic policy should also be directed towards the same end. But the time for that has not yet come.

Special difficulties of India.

In the next place, it has already been pointed out that it is difficult for a debtor country to secure economic equilibrium by adjusting internal prices to costs. India is so heavily burdened with external obligations apart from mere debts that she cannot afford to sacrifice external equilibrium for the sake of internal adjustment. In any case, even if internal stability is theoretically more desirable, we cannot, in view of our present political and economic condition, do without external equilibrium. It should not be forgotten that our exports have now a much more restricted market than in the past and that this state of affairs is likely to become more serious in future. For example, Germany which, next to the United Kingdom, was the largest buyer of Indian goods before the War, has already begun to take an increasing quantity of Italian rice and Brazilian cotton in the place of Indian products. The result is that our pre-war export surplus of Rs. 13 crores in the Indo-German trade was transformed into an adverse balance of Rs. 284 lakhs and Rs. 277 lakhs respectively in 1934-35 and 1935-36.¹

Limited number of exports.

As pointed out in Lecture VIII, we have also a limited number of exports with which to square our balance of payments. How precarious our position is will appear from Table No. 40. It may be pointed out that nine items account for more than 80 per cent. of the entire export of merchandise from India. Not only this, the percentage share of each item shows great fluctuation from year to year. Thus during 1931-32

¹ *Review of the Trade of India in 1935-36*, p. 146.

and 1932-33, the percentage shares of cotton (raw and waste) were 15.26 and 15.63, whereas during 1934-35, it was as much as 23.15. Similar changes are noticeable in the case of other commodities as well. Raw jute represented 9.80 per cent. of the exports during 1928-29 but only 5.84 per cent. during 1930-31. Thus although we are supposed to have a monopoly in this product, our position is not free from anxiety. As stated in the *Report of the Jute Enquiry Committee* (page 39), "Competition has developed along two main lines, viz. :—

(1) The increased adoption of bulk handling is progressively eliminating jute-sacks as containers for grain in transit;

(2) The substitution of jute by paper, and to a less extent by cotton, for the making of bags". Apart from this, the fortunes of a packing material are inseparably bound up with activity in the world's markets and must necessarily be affected by trade cycles. It is therefore clear that our ability to meet our foreign obligation is so precarious that we cannot afford to risk it in any way.

TABLE 40.

EXPORTS FROM INDIA.

(Data from *Annual Review of Trade of India*.)

Percentage of total exports in merchandise.

	28-29	29-30	30-31	31-32	32-33	33-34	34-35	35-36
Cotton (raw and waste)..	20.20	21.11	21.19	15.26	15.63	18.44	23.15	21.47
Jute manufactures.	17.24	16.71	14.46	14.06	16.40	14.60	14.20	14.63
Tea.	8.06	8.37	10.68	12.47	12.96	13.56	13.32	12.35
Jute (raw).	9.80	8.74	5.84	7.18	7.35	7.47	7.19	8.54
Grain, pulse, flour	10.21	11.19	13.55	13.17	12.14	8.03	7.83	7.73
Seeds.	8.97	8.52	8.10	9.36	8.54	9.33	6.97	6.43
Metals and ores.	2.70	3.33	3.60	3.51	3.54	3.75	3.91	4.82
Leather.	2.82	2.63	2.90	3.43	3.60	3.61	3.63	3.51
Hides and skins (raw).	2.90	2.57	2.48	2.31	2.09	2.91	2.07	2.57
All other items.	17.10	16.83	17.20	19.32	17.75	18.30	17.73	17.95
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Rigidity of economic structure.

Even if we assume for the sake of argument that the conditions in the external world are such that they do not upset our internal equilibrium, it by no means follow that prices can be adjusted to costs by currency authorities without difficulty. It is true that we do not have strong trade unions but our economic structure is none the less rigid. The chief components of costs, viz., wages of unskilled labour, wages of skilled labour and rent of land¹ are not very flexible.

¹ We cannot brush aside rent as an element of cost unless we make the unreal assumption that land is used only for agriculture and not for any other industry and that agriculture is a single industry with a single product. (See Henderson's *Supply and Demand*, p. 101.)

The capital market is so imperfectly developed that the exigencies of public finance affecting the yield of Government securities, more powerfully influence the long-term rate of interest than any demand for new industrial investment. This was well illustrated by the movement in the values of $3\frac{1}{2}$ per cent. Government paper and of speculative and non-speculative industrial securities during the depression and also before and after.

What price level to stabilise?

The difficulty of maintaining production has already been referred to in connection with stabilising employment and incomes. What then should be the objective of our currency administration? We have already considered the rival claims of price-stability and of exchange-stability, from the point of view of abstract theory. It now remains for us to examine it with reference to the existing economic condition of India. In the first place, what price level are we to stabilise,—the price of food crops, the price of commercial crops, or the price of manufactures? Each can be supported on solid grounds. The dilemma is very real. In the course of his evidence before the Stabilisation Committee, Governor Strong pointed out his difficulties in face of rising Stock Exchange prices and falling agricultural prices.

Is there a common Consumption Standard?

On the other hand, it has been suggested that we should try to stabilise the purchasing power of the rupee and not its command over food crops, or commercial crops or manufactures. This also is not free from difficulties. My brother Dr. H. Sinha in his address before the Marshall Society at Cambridge in 1934 on the Reserve Bank referred to some of them. He made it clear that India is so big and so heterogeneous that there is no one standard of living for the whole country. Even in the case of urban workers, whose ways of life are more standardised, wide disparity is noticeable not only in different parts of India but also among different communities in the same place. Thus for Rangoon there are as many as four separate cost of living index numbers. Apart from this, there is very little in common between an urban worker in a factory and a rural worker, growing food crops mainly for his own consumption and living in his own thatched hut. It is idle therefore to speculate about a common consumption standard for the whole of India whose stabilisation would lead to the stabilisation of Indian economic life.

Difficulties of stabilisation.

It is also to be noted that price stabilisation is difficult all the world over and more so in India because of the inadequacy of financial machinery. Leaving this point for the moment, even in countries so well organised as the United States of America, the matter is exceedingly

complex. We have referred above to the evidence of Governor Strong before the Stabilisation Committee. He summed it up by saying "I have discussed these matters with many economists and students of politics. . . . We have agreed on the record of the past . . . pretty generally, as to what has been done and the effect of what has been done. We have generally agreed as to the conditions at the present moment. . . . But when I ask them, now we have got to decide something to-day; you are in the position of running in the Federal Reserve System; what are you going to do to-day that will have an influence on the future? the answer is always the same. 'Well, you are practical fellows, who are running this; you have got to decide that.' And that is the difficulty. Our examination of the past produces the most accurate knowledge of past action and reaction, but when it comes to a decision as to what we are going to do for the future, then just human judgment has got to govern. There is no mathematical formula for the administration of the Federal Reserve System or the regulation of prices". The Canadian Macmillan Committee was more explicit and plainly stated: "It is . . . not desirable that central bank should be specifically charged with any responsibility for the general price level of a country. There are many factors of varying nature, which combine to influence that level, and a central bank, working as it does purely in the monetary sphere, cannot be expected to have complete control. . . . If it attempted to exercise any drastic control it would have to wield powers far beyond those which any body other than the sovereign authority would be entitled to exercise".

Exchange stability, the only possible objective.

Apart from such difficulties, we have to consider the peculiar difficulties due to inadequate control and defective organisation of currency in India. What cannot be tackled in advanced countries of the West cannot *a fortiori* be achieved in India. It is thus a case of Hobson's choice with us. The only objective which currency authorities in India should have in view is exchange stability. A *caveat* is here necessary. Should we have stability in terms of gold or of sterling? In the short period, it should be with reference to sterling, more so as sterling is kept reasonably stable in terms of gold through the operation of the British Exchange Equalisation Fund and in other ways. In the long run, when the rest of the world reverts, as it must, to some form of gold standard, India should follow suit. That standard will be different from previous gold standard. There will have to be wider gold points, more adequate reserves, better organised forward exchange markets and similar devices to maintain gold parity. It is even conceivable that a worsening of the exchange rate may have to be tolerated for a pretty long period in order not to impair internal economic equilibrium. But a movable parity on the lines suggested by Sir Arthur Salter is out of

the question. The game of altering the gold value of currency cannot be played too often, specially by us in view of the imperative necessity of meeting our foreign obligations which will be fixed more or less in terms of gold.

Control of currency or of credit?

Reference has been made already to the financial machinery necessary for attaining the aim of monetary management and control, which we now proceed to examine. We must begin by saying that control may be exercised either through currency or through credit or through both. It is often said that India's currency problem is at bottom a banking problem and that a greater development of banking would cure her currency troubles. In the abstract sense, this is probably right. But in the conditions actually obtaining in India at present, currency control is likely to be more effective than banking control, as stated by Sir Dadiba Dalal in his Minute of Dissent to the Babington Smith Committee Report. We have not yet progressed far from that stage. In the debate on the report of the Hilton Young Commission initiated by Sir James Brunyate in the Royal Society of Arts in 1926, Mr. Hawtrey rightly pointed out: "In India it was true to say that the control of credit was subordinate to the control of currency,—it was more like England a hundred years ago". In spite of the development of branch banking by the Imperial Bank of India, the abolition of stamp duty on cheques, the increased facilities for remittance provided by the Imperial Bank of India, and lastly the setting up of the Reserve Bank of India,—in spite of all this, currency control is even now the chief method of monetary management.

Position of the rupee

Currency may be either in the form of notes or in the form of rupees. To deprive the rupee of its present legal tender status and to reduce it to the position of subsidiary coins cannot be contemplated for many years to come. For a backward country like India cannot do without 'hard' money. Paradoxical as it may seem, a rupee note is less profitable to Government than a silver rupee. The average abrasion of a rupee is 1.5 per cent. in fifty years whereas the average life of a rupee note is only six months.¹ This is the reason why the Inchcape Committee recommended the withdrawal of one-rupee notes from circulation. Notes of higher denominations have longer lives, but they cannot serve for small transactions which predominate in India. We know that a rupee is frequently referred to as a note printed on silver. But because it is printed on silver, its expansion and contraction are more difficult

¹ On this basis the assumed annual profit of one-rupee note was Rs. .0032 as against Rs. .0082 in the case of the silver rupee. (*Report of the Indian Retrenchment Committee, 1922-23, p. 240.*)

than those of paper currency. What is more, the course of silver prices has proved so erratic that the face value of the rupee has sometimes been above its bullion value,—a fatal defect which created trouble for us in the past and may cause difficulties in the future.¹

and of notes and bank deposits.

We have already pointed out in Lecture V that the proportional reserve system has given a much needed elasticity to our currency system. With the unification of credit and currency control in the hands of the Reserve Bank of India, and concentration of member banks' deposits with them, an additional flexibility has been imparted to the system. The need for seasonal expansion has also been abated by mitigating the evils of the exodus of crop-moving funds from headquarters to mofussil areas and *vice versa* by remittance facilities discussed in Lecture V. The Reserve Bank of India has improved such facilities. Once a week, member banks may remit free of charge Rs. 10,000 or multiples thereof between places where there are branches of the Imperial Bank of India. If remittance is effected by T. T., telegraphic expenses and the stamp duty of one anna have to be paid. It is only when money has to be sent oftener than once a week, a commission of 1/32nd of a rupee per cent. is charged. This seems to be satisfactory. But there is room for improvement in administrative detail. The time has now arrived when the limit should if possible be reduced to Rs. 5,000, so as to enable the smaller banks to avail themselves of these facilities. It is also reported by some banks in Calcutta that the advice from up-country branches to the Calcutta office of the Imperial Bank on receipt of which the amount in question is credited to the account of the member bank through the Clearing is frequently delayed in transit. There is report of a similar delay when money is sent by T. T. Surely this should not be so. Before the inauguration of the Reserve Bank, such transfers were effected through demand drafts and did not involve so much delay. It has to be emphasised once again that to the extent mobility is imparted to our currency system, the need for currency and credit control will be minimised.

What can credit control achieve?

The expression 'credit control' is used in various senses in different contexts. At the outset it is necessary to remember that any drastic control is difficult in all countries and impossible in India. Clark in

¹ Only in May, 1935, the U.S.A. Treasury raised the price of silver to 77·57 cents an ounce and it was freely rumoured (and confirmed by Mr. Morgenthau) that the Treasury would not stop till the price was forced up to \$1·29 1/4 an ounce. (*Economist*, May 4, 1935.) With the rupee-sterling exchange at 1s. 6d. and the London-New York cross rate at \$4·85 (the rate current at the time) the value of silver contained in a rupee was about 98 cents an ounce. Hence the danger of the rupee going to the melting pot was very real, although happily for us it proved short-lived due to the collapse of silver prices.

his *Central Banking under the Federal Reserve System* has cautiously but wisely stated: "Through sound policies and practices (of central banking) a direction should be given to financial and business operations resulting in a safer and more stable economic order". This appears vague and otherwise unsatisfactory. Unfortunately, as has already been made clear by Governor Strong's evidence before the Stabilisation Committee, central banking cannot be resolved into a number of simple rules. It is therefore necessary to examine the technique of central bank regulation. Credit rationing is out of the question in India for the Reserve Bank at present is neither sufficiently strong nor sufficiently respected to be above the charge of favouritism. As regards moral suasion its effectiveness depends on the one hand on the type of the member bank to whom warning or advice is given and on the other on the power which the central bank keeps in reserve. Unless the status of the Reserve Bank attains that of say the Bank of England, and the status of commercial banks is equally well improved, it is futile to expect useful results from moral suasion. Thus in its capacity as a "marginal lender" (in the words of Gregory) or "a lender in the last resort" (in the words of Hayfron) that the Reserve Bank is likely to make its influence felt. We have therefore to examine the ways in which the Reserve Bank can bring itself into the position of a marginal lender.

Limitations of open market operations

As is well known, one of the ways is through open market operations. The question is, is the securities market in India sufficiently wide to enable the Reserve Bank to buy and sell without considering the repercussion on the public finance of India? It cannot be too much emphasised that to be fully effective a policy of sale must result not only in decreasing loanable funds in the money market but in increasing the long-term rate of interest. In that case the short-term rate is forced up for a double reason, firstly because the loanable funds are less, and secondly because the long-term rate is higher. It is doubtful if the Reserve Bank can carry on operations on any drastic scale and coerce the money market into submission in the conditions obtaining at present.

and of bank rate policy.

The other weapon, *viz.*, discount rate policy is equally blunt. There is some criticism among some Calcutta banks that both the Reserve Bank and the Imperial Bank are prepared to lend to scheduled banks on the security of Government paper at the Bank rate but the former charge interest for a minimum period of one week whereas the latter charge interest during the actual period of the loan, which may be as short as one day. This is exactly as it should be, for the Reserve Bank should be the marginal lender. The real point of criticism is that the Bank rate does not permeate the whole banking system. Indigenous banking

is not affected by the Reserve Bank rate to any material extent, although according to Sir George Schuster, 90 per cent. of Indian banking is in the hands of indigenous bankers. This does not appear to be an over-estimate in view of the fact that the internal trade is about fifteen times the foreign trade which is of the order of Rs. 300 to Rs. 400 crores. If we consider the advances made by scheduled banks which amount to less than Rs. 100 crores, we may form some idea of the preponderating importance of indigenous banking.

Linking of indigenous with organised banking.

The question is, how to link this indigenous banking with the organised banking system, for herein lies the crux of the problem of credit control. A number of proposals have been made by Provincial Banking Inquiry Committees. One is that indigenous bankers should be appointed as agents of the Reserve Bank at places where there is no organised bank, provided they agree to be subject to certain restrictions so as to eliminate risks arising from speculation or their own business. Is this possible? Even now joint stock banks find it exceedingly difficult to find acceptable local investments for the employment of their funds in the mofussil. Will not the difficulty be greater in more remote regions? Indigenous bankers carry on trading along with banking because otherwise they cannot engage themselves both during the busy season and the slack season. The volume of banking business is much too small to pay its way unless it is supplemented with trading. In his *Indigenous Banking in India*, Dr. Jain has suggested that they should form a joint stock bank. That is a case of improvement out of existence. The reason for the survival of indigenous banking in face of modernisation of the economic life in India in all its phases is that it fits in with the daily life of the people, their habits and temperament, their follies and foibles. A shining counter, a cheque book, delays and formalities, fixed hours of business—all these are foreign to the genius of the people in the countryside. In fact, no heroic measure involving a definite break with the present order is possible. The following suggestions are made, although it is recognised that it must take years before they can produce the desired results.

Remittance and rediscounting facilities.

In the first place, remittance and re-discounting facilities must be provided to as many indigenous bankers as possible.¹ We have stated

¹ But in view of the definite recommendation of the Indian Central Banking Enquiry Committee, recently endorsed by the Reserve Bank of India that rediscounting facility should be given only to such indigenous bankers as are engaged in banking proper or are prepared to give up their non-banking business, it is doubtful whether this facility can be availed of by any appreciable number of these bankers in the near future. (The footnote is continued on the next page.)

above that the limit of free remittance should be reduced. Rediscounting facilities are out of the question in the absence of a proper bill market. Even in the case of England, there seems to be scope for improvement. The Macmillan Committee suggested: "All concerned would benefit by a more extended use of commercial bills (*i.e.*, bills given by a purchaser to a supplier).....To those who find it necessary for good reasons to give extended credit, finance would be rendered more easy if their 'accounts receivable' were in the form of commercial or trade bills rather than in the form of mere debts". If that is so in England, the necessity of developing the bill market is all the greater in India. It is often said that the system of cash credit in vogue in India is advantageous both to the borrower and the lender: to the former, because interest has to be paid only on the amount of credit used and to the latter, because credit can be withdrawn in the event of deterioration of the financial position of the borrower. Herein lies the weakness of the system. One advantage of commercial bills over cash credit is that in the case of the latter "the loan is not necessarily automatically paid off when the transaction is completed". In good times banks may not insist on the paying off of the overdraft as long as interest is being regularly paid. The result is that with the approach of the slump both the bank and its customer get into difficulties. Many such instances may be cited from the recent history of Indian industrial finance.

The heavy stamp duty.

The chief obstacle to the wider use of bills in India is the heavy stamp duty, whose abolition was recommended by the Hilton Young Commission. This was indorsed by the Central Banking Inquiry Committee which further recommended as an initial step the reduction of stamp duty on all bills of less than one year's usance to a uniform rate of 2 annas per Rs. 1,000. This is long overdue. In fact, the incidence has now become very onerous due to the fall in the rate of interest, as made clear in the report recently issued by the Agricultural Credit De-

(Continued from the last page.)

One method of extending modern banking facilities to the countryside is to establish a closer contact between co-operative banks on the one hand and ordinary joint-stock banks and the Reserve Bank of India on the other. The facilities which co-operative banks at present enjoy in respect of remittance of funds for co-operative purposes, should be continued by the Reserve Bank. In regard to transactions other than strictly co-operative, the facilities at present granted by the Reserve Bank to joint-stock banks, might also be extended to provincial co-operative banks provided the latter are prepared to maintain more fluid resources than they seem to have at present. There should also be a systematic attempt to link not only the provincial co-operative banks but also co-operative central banks with the commercial banks. This is likely to prove more fruitful in the near future than the recent proposal for bringing indigenous bankers within the fold of organised banking. It is interesting to note that China has attained a fair measure of success in providing banking facilities to rural areas by establishing a link between her co-operative societies and modern banks.

partment of the Reserve Bank of India. It is also stated that even if the duty is considerably diminished, the Provincial Governments may not suffer any appreciable loss of revenue, for although the amount realised on each bill will be smaller, there will be a greater number of bills. It may be pointed out that the stamp duty on bills, rightly called a nuisance tax in the U.S.A., was abolished there, after the setting up of the Federal Reserve system.

It may be hoped that with greater development of banking, bankers will be increasingly eager to discount bills for employing their funds in a safe and liquid manner. Some of these will be rediscounted with the Reserve Bank, it being no longer regarded as derogatory for any bank to obtain funds in this way. Possibly, a lower rate of interest may be levied for discounts than for loans. But these and similar measures may be adopted only after the stamp duty is considerably reduced.

Rupee import bills.

It should be recognised that the development of a bill market although so desirable is not at all easy. The Reserve Bank of South Africa and the Federal Reserve System of the U.S.A. have both experienced serious difficulties in weaning bankers and traders from the habit of using promissory notes or open accounts into the practice of using bills. It is therefore necessary on the one hand to remove impediments such as heavy stamp duty, and on the other, to offer inducements such as easier terms for discounts. For overcoming their inertia, it has been suggested that rupee bills should be drawn in respect of imports into India. If they are drawn on bankers under letters of credit opened by them, they will be very eligible securities for the purpose of short loans. Unfortunately the time for that is not yet. Our rupee must acquire a better status in the financial world, our banks must be better known and more widely respected before this will be possible.

Rupee export bills.

Of greater practicability is the suggestion about the drawing of export bills in rupees. Such bills need not be in terms of sterling, nor need they necessarily be drawn on the banker abroad opening the letter of credit, as at present. To fix our ideas, let us suppose that Lloyds Bank, London, opens a letter of credit in favour of the Indian Export Company. The latter bring the bill with the relative documents to any Calcutta bank, which will discount the bill without any hesitation, relying on the promise of Lloyds Bank, London, to pay the bill on the due date. If, now, the bill is drawn in rupees on Lloyds Bank, Calcutta, the security from the negotiating banker's point of view will be no worse, provided of course the bill is discounted after acceptance is procured from Lloyds Bank, Calcutta. The advantage is twofold. In the first place, rupee bills pay stamp duty only once, whereas sterling

bills pay duty twice, once at the time of drawing the bill in India, and again at the time of presentation for acceptance in London. In the second place, the Indian Export Company may not want cash for the bills immediately. If they hold the rupee bills accepted by Lloyds Bank Calcutta, they may have cash any time they require. They need not carry idle money pending their next shipment.

The only drawback under the proposed arrangement is that the discount payable in Calcutta may be higher than that in London. If, however, the discount rate in Calcutta can be reduced, so as not to be very much above the London rate, this difficulty will be considerably minimised.

In the U.S.A., export bills have developed somewhat more rapidly than import bills, because of the fall in the rate of discount there. When the late Sir Basil Blackett first made this suggestion, the discount rate was much too high in India to enable the export trade to be financed more cheaply through bank acceptance credit than through the usual cash credit system. Conditions have changed considerably since then. The time seems to be opportune for making a determined attempt to break the inertia.

Other drawbacks.

It is to be remembered, however, that if bills and *hundis* are more widely used for internal trade, indigenous banking will be brought into closer touch with organised banking. The heavy stamp-duty is not the only obstacle in this respect. Goods are not properly standardised. Warehouse-keeper's warrant and other documents of title are imperfectly developed. The whole method of trade militates against the use of bills. On the other hand, it has been suggested that a document of title such as a railway receipt should be given the status of negotiability not inferior to that of a bill of lading. The essence of negotiability is that the transferee acquires a better title than the transferor, and therefore the document can pass from hand to hand with safety and convenience. If the railway receipts describe the goods vaguely so as to minimise risks on the part of railways, if delivery has to be frequently given under indemnity bonds in lieu of railway receipts either because they are not forthcoming or because they do not arrive before the goods, it is clear they are not acceptable securities from the banking point of view. Rather if railway receipts and properly made out invoices accompany bills, they can be discounted much more readily than the present clean bills or *hundis*.

A hopeful feature.

We have referred so long to the difficulties facing the Reserve Bank of India. It is pleasant to refer to one hopeful feature. The

demand liabilities in India of scheduled banks in March, 1936, the closing month of our narrative, were Rs. 120 crores and the time deposits were Rs. 101 crores. Five per cent. of the former and two per cent. of the latter have to be compulsorily deposited with the Reserve Bank. Thus the balance necessary by statute to be kept with the Bank amounted to only Rs. 8 crores, whereas the actual balance was nearly Rs. 36 crores. It shows that the Reserve Bank in India has been able to secure the willing co-operation and confidence of scheduled banks within the short time of its existence.

Difficulties in the way.

This is a happy augury for the future. For unless the scheduled banks, banks outside the organised system, Government, traders and may we add politicians and economists unite in lending strength to the elbow of the Reserve Bank, it will not be able to discharge its duties satisfactorily. These duties are specially onerous in the case of India. In the first place, it is clearly desirable to stimulate the economic development of India at a rapid rate in order to make up much leeway. That by itself, apart from any other reason, will make our banking system difficult of management. For it is common knowledge that one reason for financial crises in the U.S.A. and for comparative stability in the United Kingdom is that the pace of economic development in the former is more rapid than in the latter. In the second place, we have all the difficulties inherent in the economy of an agricultural country, with large seasonal swings and having a limited number of exports exposed to world competition. In the third place, we are a debtor country, with default practically ruled out. It is true that we have normally a favourable balance of trade, but the situation is by no means free from anxiety, as explained above. Fourthly, we have not yet completely outgrown the stage of barter. In spite of the commercialisation of agriculture, due to improvement in transport, subsistence farming still prevails over wide areas. The ryot in many cases consumes a substantial portion of his own produce. He sells only the surplus for meeting his monetary obligations and for the purchase of salt, kerosene, cloth and such other requisites. This makes currency management more difficult in India than in the West. Fifthly, the lack of proper balance between agriculture and manufacture makes our economic life more vulnerable to external disturbances. In these days of aggressive economic nationalism, a more self-sufficient economy would have made monetary control easier. Finally there are inter-provincial differences, some of which were referred to in the earlier lectures. Politically India has been made a Federation, but economically she is still a unitary state. This has given rise to a series of problems, some of which will need the careful attention of the Reserve Bank of India.

At the same time, it should be the constant endeavour of the Bank not to kill the initiative of scheduled banks and other financial institutions but help them forward on sound and correct lines as far as possible. Let it not be impatient if it is not able to achieve immediate results. It is useful to recall the wise words of John Stuart Mill, which are as true of an economic institution like a central bank as of a political state:—

“A state which dwarfs its men in order that they may be more docile instruments in its hands, even for beneficial purposes, will find that with small men no great thing can really be accomplished.”

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