THE

Ratio Controversy in India: A RETROSPECT

BY

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This retrospect and review of the Ratio Controversy in India was first published as an article in the *Asiatic Review* of July 1929, and I am obliged to the editor of that journal for permission to have it reprinted. I have availed myself of the opportunity furnished by the present reprint to make considerable additions to that article in the hope that it might prove of some assistance to the public in examining the leading aspects of the Ratio problem. Our controversy on the ratio question forms an important phase of the great currency controversy of the post-war period relating to deflation and stabilisation. It will also occupy an important place in the economic history of India. This little book is designed to serve as an introduction to a subject of such many-sided interest and as a discussion of its main issues in the light of the economic developments of the post-war period.

J. C. C.

THE RATIO CONTROVERSY

THE scheme of monetary reconstruction which the Royal Commission on Indian Currency put forward was a very comprehensive one; it contemplated among other things the establishment of an up-to-date and automatic currency standard, the constitution of a currency authority in the shape of a Reserve Bank (which should combine the control of currency and credit), and the thorough overhauling of the paper currency system of the country. Nevertheless, the controversy which followed the publication of the Report of the Commission has raged only around two points of this programme—the ratio and the constitution of the directorate of the proposed Reserve Bank. The surprise with which one regards this selection of two apparently isolated points of the programme for criticism is, however, removed when we remember that the controversy in India over the ratio question is the counterpart of the great struggle which has taken place in most countries after the war between the advocates of inflation and those of the return to a steady and moderate price level. It is also significant that the same set of critics who argued for the reversion to the lower ratio (with inflation as its corollary), also worked for the object of placing legislators on the directorate of the Reserve Bank and of thus bringing political pressure to bear directly on our future banking policy. In fact, the real issue in the controversy is that of inflation; and that fact accounts in the main for the vitality of the controversy. For, if adjustment of prices to the ratio was indeed the real issue, few would be found to assert in this year (1929) that things had not adjusted themselves in a preponderant degree to a ratio which had held the field for five years, and the controversy would have died a natural death before now. But the ratio controversy derives its whole vigour and momentum from the inflationist aspirations behind it; it is the Indian counterpart of the struggle over readjustment of price levels to normal conditions which has been the most important economic movement of the postwar epoch in most countries of the world. It is on that account that the present controversy will occupy a not unimportant place in the economic history of India.

THE "NATURAL" RATIO

There has been much misunderstanding over the character and origins of the former 1s. 4d. ratio. Thus that ratio has been called the "natural ratio" and "the permanent ratio.' It has been even confused with the currency standard itself, and in the dissenting minute of the Currency Committee of 1919 it has been called the "standard ratio." But a glance at the history of the ratio will show that those who proposed and sponsored it expressly disclaimed any permanent character for it. Thus the Herschell Committee was careful to explain the character of the ratio in its Report. "It would not, of course, be essential to the plan that the ratio should never be fixed above 1s. 4d.; circumstances might arise rendering it proper and even necessary to raise the ratio." So also the Fowler Committee was careful to emphasize the necessity of "the final ratio being fixed either below or above 16d., as further experience might show to be expedient." It added further that "between the rate of today and that determined by the bullion value of the rupee, there is none that can be described as natural or normal."

The advocates of that ratio would also do well to remember that the Fowler Committee in deciding for a 1s. 4d. ratio employed the very same arguments which were used by the Currency Commission of 1925-26 in order to justify the present 1s. 6d. ratio. The Fowler Committee expressly overruled every plea and answered every argument that the opponents of the 1s. 6d. ratio have put forward in our own days. Thus the Committee's main argument on behalf of the 1s. 4d. ratio was that "the rate of 1s. 4d. is that of the present day; prices in India may be assumed to have adjusted themselves to it, and the adoption of a materially lower rate at the present time would cause a distinct and, in our opinion, a mischievous disturbance of trade and business." Another ground on which the Fowler Committee recommended the 1s. 4d. ratio was that in 1898-99 the prevalence of that ratio was found to be compatible with a large favourable balance of trade. The pleas that "the *status quo* had not been arrived at without manipulation and that a *fait accompli* in the shape of an established ratio and a price adjustment thereto had been presented to the Committee" were also overruled by that Committee. Not only is there a close and instructive parallel between the arguments employed by the Fowler Committee and the Royal Currency Commission of 1925, but the case for a 1s. 6d. ratio was much stronger in 1926 than that for a 1s. 4d. ratio in 1898. Little statistical proof was brought forward in 1898 regarding the adjustment of prices to the older ratio, while the ratio itself had been prevailing only for about a year. Finally, the rise of the ratio to 1s. 4d. in 1898 was a very slow and hesitating affair indeed compared to the attainment of the 1s. 6d. ratio in 1925.

In the light of the above historical examination of the reasons for the establishment of the 1s. 4d. ratio in 1898, we can see how little ground there is for the contention that any later change of the ratio constituted "a wanton tampering with the standard of value." Gold has been restored as the standard of value in India, and gold will be—with the adoption of the proposals of the Commission of 1926—more than ever the basic currency "from which the other monetary instruments derive their own exchange value owing to convertibility." The essence of the gold standard is the tying of the value of our monetary unit to the value of gold. But it cannot be contended that any particular ratio once adopted should or could be maintained for ever, regardless of important changes in prevailing conditions—for example, great changes in prices of precious metals. The factors which the Fowler and Herschell Committees took into account in recommending the 1s. 4d. ratio show that in their view the ratio was not either unalterable or of the essence of the currency system; for they based it professedly on a consideration of the prevailing facts of their own day as regards prices, trade conditions, and the relative prices of the precious metals. It is, of course, true that a standard unit of value once adopted should not be arbitrarily departed from; for any random changes in the standard of value are sure to cause losses to some people. So far one can respect the zeal shown for the older ratio. But the changes in our ratio in India have been such as were absolutely necessary in the interests of the stability of prices—*i.e.*, of social justice. A statistician would be staggered at the number and the size of the fluctuations of prices which India would have experienced if she had adopted the policy of sticking to the old ratio at all costs since the war. It is true that the 1s. 4d. ratio held the field for nearly twenty years; but it need not be forgotten that more recently it was in abeyance for a whole decade—and for a decade which has seen currency and trade changes enough to crowd a century. Under these conditions the currency authority which is proceeding to stabilize the ratio would be well advised to consult the facts of the day for his guidance rather than the conditions prevailing three decades ago. In such an important affair those who admire the work of the Fowler Committee would do well to imitate its procedure.

Those who argue for the maintenance of 1s. 4d. as a natural ratio certainly ignore the fact that there is a dynamic side to the problem of the ratio of exchange under the Gold Exchange Standard. To this aspect attention has been recently drawn by Prof. Taussig, a distinguished economist, in his discussion of the Gold Exchange Standard.* He has urged that the maintenance of the fixed rate of exchange depends upon the continuance of certain fundamental conditions. "Changes from any established situation, any current rate of exchange, *however firmly it seems to be imbedded*, do occur. Demands will change, new articles of export and import will appear, the balance of international payments will need to be

* Taussig, *International Trade*, p. 382.

readjusted; then what?" Here is a formidable attack by an impartial and eminent authority on the idea of an irrevocably fixed "natural" ratio. His theoretical argument is strongly supported by the facts of the economic history of India; and India is a particularly good illustration of such theory in as much as it is a country producing raw materials for which the demand has grown more intense both during the war and after the war when economic reconstruction of the world has increased the demand for such products. At the same time, the demand of India for foreign manufactures has grown less intense on account of the growing industrialisation of our country under the regime of Discriminating Protection. The events of the last few decades emphasise the validity of this line of reasoning. Indeed an important contributory cause of the great rise of prices in India before the war was not the Gold Exchange Standard but the ratio which had become ill-adjusted to the circumstances. Thus in the latter period of the war and right upto 1920 not many could be found to urge the claims of the 1s. 4d. ratio as *sacrosanct*. Indeed a leading industrialist and economist of India like Sir V. Thackersey advocated a stabilisation at 1s. 6d. It is also significant that a strong advocate of the 1s. 4d. ratio like Sir D. Dalal proposed a general export tax as the means of keeping up the old ratio. In such an extreme proposal is implied the same basic idea of the dependence of the ratio upon foreign demand for our products which has been explicitly put forward by Prof. Taussig. After 1920 came the great and general trade depression which for a time lowered the Indian ratio. But the action of the basic economic conditions of the world's demand for Indian products could not be long withstood, and our ratio was not only stabilised at 1s. 6d. but it rose a good deal above it inspite of large purchases of sterling by Government. Indeed "it was believed that Government would not be able to keep exchange from rising considerably above 1s. 6d." The true correlation thus is to be traced between our exchange ratio and the course of the trade conditions.

"EARLIER OPPORTUNITIES" OF STABILISATION

The contention has been advanced that suitable opportunities for stabilising the exchange at 1s. 4d. occurred in the years 1923-24, but that advantage was not taken of them. That contention can, however, be shown to rest upon a faulty perspective of the financial, monetary and commercial conditions of the time. As was well recognised, the *sine qua non* of the stabilisation of the rupee was a budgetary equilibrium; and that preliminary condition of stabilisation was not well assured by the years 1923 or 1924. Another desideratum was the improvement in the position of India as regards foreign trade, which implied, in its turn, an improvement in the trade conditions of the world.

The budgetary equilibrium which was admittedly an essential prerequisite of the stabilisation of the rupee was not reached until the year 1923-24 when a start was made with a surplus of two crores. As Sir B. Blackett put it, it was "the Budget of 1924-25 which signalised our definite escape from the era of deficits."

Indeed, as late as the year 1926, some eminent Economic authorities both in India and abroad were of opinion that the time was not ripe for the stabilisation of the rupee. The stabilisation of our currency and exchange was in an important sense an international problem, and one of the leading considerations in determining whether the time for stabilisation had arrived was the possibility of a reasonable estimate of the future course of world prices and monetary policies. Naturally, the maintainability of any ratio to be fixed for India depended to a very great extent on the then uncertain course of prices and monetary developments abroad. In the quinquennium 1920-25 great monetary developments have taken place in various countries and economic opinion on important currency matters has been in a state of flux—there being on one hand a tendency to go back to pre-war arrangements and on the other hand strong suggestions to make radical departures from them. The price and discount policies of the leading countries had been discussed, experimented upon and gradually and in some measure settled. Nor, with the best intentions, had it been possible to prevent considerable price fluctuations. Prices in England went through a great fall through the years 1920 and 1921. There was another but much smaller rise of prices in 1922-23 and a later fall in 1925.

American prices too had gone through great fluctuations between the years 1920 and 1925. In that country there were noted during the period no less than three periods of rising prices—1920, 1922-23, and 1924-25—and two periods of falling prices corresponding to the years 1920-21 and 1923-24. Many other countries had their full share of what Prof. Edie has well termed the "outstanding phases of this period of price turbulence." He added that "this shifting of relations is not confined to money and prices alone. It extends to the outside factors, such as unbalanced budgets, foreign exchanges, industrial and trade conditions and psychological changes reflected in optimism and pessimism."

Such uncertainty of prices and of price-policies in the leading countries added greatly to the risk of maintaining any ratio that had been fixed at that time. Had the gold prices fallen materially, after India had fixed such a ratio, we should have had to undergo a further and strong deflation with all its inconveniences. On the other hand, there were powerful partisans of inflation both in England and in the United States at the time. The danger was the greater from any inflationist success in the latter country, with its vast accumulated gold resources and its position as the great creditor country. Looking to the banking situation in the United States, Bonnet* well remarks that with the bank reserves climbing up at some periods as high as over 80 per cent. at times, the maintenance, on the whole, of a wise and moderate credit and price policy on the part of the Federal Reserve Banks has been a marvellous and wholly unexpected phenomenon. This is to be attributed to the new spirit which has actuated the Federal Reserve Board and the new task which it has set before itself. That task has been to keep the purchasing power of money stable, an aim that was almost unknown to the pre-war banking theory or practice, generally speaking. The method adopted has been not to avoid all increments of credit but to so regulate it as to keep prices steady. The method was, of course, not learnt

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* Bonnet, *Experiences Monetaires Contemporaines*, p. 58.

in a day, and a great mistake was made at the start in 1919-20 in the great expansion of Reserve credit. But as time went on, the new ideals and methods were adopted not only in America but later in England also. However, at the time of which we are speaking—in the years which followed the Indian Currency experiment of 1920—there could be no assurance or even glimpse of such a new and wise price policy to be followed by America. Nor, further could it have been anticipated how, under the guidance of the late Governor Strong, America would assist in the monetary reconstruction of a number of European countries, and thus facilitate the task of monetary reform generally. Before that development the only hope of the stabilisation of prices and currencies seemed to be in an international cooperation guided by international conferences. We know that Dr. Vissering and other economic authorities worked since 1920 in that direction. But we also know how frequently futile and generally dilatory such conferences can be. Fortunately, however, events took a new and unexpectedly favourable turn about the year 1924-25.

DEFLATION

It has also been contended that the stabilisation and maintenance of the exchange at 1s. 6d. was due to currency manipulation in the shape of "excessive deflation" and "undue contraction of currency in India." It is submitted here that there is a double fallacy involved in this line of reasoning. Not only is the extent of the actual deflation exaggerated, but the efficiency of monetary deflation as a factor in monetary stabilisation is unduly magnified. Compared to the great inflation of the war period in India, the deflation of the period from 1920 to 1923, which amounted to about 38 crores, can only be called a moderate one. The fall of prices brought about by it cannot be compared for a moment with the results of contemporary deflation in the United Kingdom or the United States; while it was a long time before any tangible effects of our deflation on the exchanges could be perceived.

The fact is that the recovery of the Indian exchange was due, not so much to the halting and moderate monetary deflation, as to a singularly fortunate combination of the various factors which are recognized as being necessary for currency stabilisation. By 1925 we had the advantage of the restoration of budgetary equilibrium, and we were reaping the benefits of that "financial" deflation which is now recognized by economic authorities as so much more efficacious for stabilisation than monetary deflation. Then, again India was entering on a new era of favourable balances of trade, and was showing a recovery from the trade depression which was unique in the annals of post-war commerce. This combination of favourable factors was partly fortuitous, but it was partly also the deserved reward of wise finance and timely deflation, as well as of that patient policy which withstood the temptations to premature stabilisation. It is owing to this combination of factors favourable to stabilisation that India has paid a much smaller price for currency stabilisation than other countries. Countries which have raised their exchange under less favourable conditions have indeed paid a stiff price for the stabilisation in the shape of increased unemployment and a great strain imposed upon the unsheltered or competitive industries. But to contend (as some critics have done) that India has to face difficulties of the same magnitude in the process of stabilisation, or to argue that the necessary period of readjustment to the variation in exchange should be at least as long in the case of India, is to disregard and ignore vital differences of economic conditions between the countries concerned.

THE HISTORY OF DEFLATION

A brief review of the history of deflation in India is very necessary in order to get a correct view of its true dimensions especially from the comparative point of view. Let us first consider the years 1920-22 when the need was particularly felt for offset-ing the great inflation of the war period and for adapting the volume of currency to the facts and requirements of the period of depression. In this period however, the process of deflation in India was greatly hampered by the budgetary deficits following on the year 1920 which led to a postponement *sine die* of the extinction of "created securities" in the paper currency reserve. "The existence of budget deficits of a substantial amount clearly made currency contraction a matter of difficulty"; nor could the sales of reverse drafts be fully utilised for deflation. The total deflation in 1920-21 amounted to 31 crores. We had nothing like the drastic deflation which took place in Great Britain in 1920-21 which halved prices, and which is now justified even by a stalwart opponent like Mr. McKenna. He observes in his book on Post-war Banking Policy that "deflation, even rigorous deflation, was a harsh necessity in 1920 and 1921." This "monetary" inflation on the lines of the Cunliffe Report was preceded by a "credit" inflation. About the same time a similarly thorough measure of deflation was carried out in America. It was a remarkable chapter in the history of post-war deflation, and by June 1920 the rediscount rate was raised to 7 per cent. A high authority like Dr. Willis asserts that "the operation of credit control through higher discount rates was a marked success." Mr. Hawtrey observes that "in so far as the expansion had got out of hand, the subsequent contraction had to be more severe."

When compared with the immense inflation during and after the war, and the lessened volume of post-war business, the succeeding deflation was certainly partial and hesitating. The extent of the inflation between the years 1914 and 1919 can be judged from the rise of the rupee circulation from 187 crores to 280 crores and of the note circulation from 61 crores to 183 crores. Later, the deficit years were financed by the issue of notes amounting to much above thirty crores. As compared with this huge inflation the deflation could not be said to be drastic in any sense. Even the sale of Reverse Councils in 1920 was not allowed to have its proper effect in deflating currency; since in other ways much of the money was replaced on the market, on the ground that adequate contraction of currency would have been "a hazardous undertaking" and that, too, while the world prices in gold were falling rapidly. The net contraction of currency in 1920-21 amounted to 31 crores and 58 lakhs; but this contraction was found "insufficient even to check the downward fall of the rupee." In the succeeding two years a net contraction of 680 lakhs was made. The credit for the improvement in Indian exchange was due far more to the balancing of the budget and to the cessation of the downward movement of the world prices than to this deflation. In fact anything like a drastic deflation was for a long time out of the question on account of the successive budgetary deficits. And, though the Paper Currency Act of 1920 embodied some ideals of ultimate deflation, even this attempt at indirect deflation was foiled, since the *ad hoc* securities could not be cancelled, and the interest on paper currency securities had to be credited to the general budget. There was still another circumstance which rendered drastic deflation impossible in the case of India, and that was the intolerance always displayed by the Indian money market towards deflation.

A most important circumstance in making the factors of stabilisation favourable to the experiment in India has been the budgetary equilibrium which has been attained for several years in India. This notable factor in the adjustment has not been even referred to in our controversy, where the critics have confined themselves to emphasising and exaggerating the monetary deflation which is a comparatively minor factor in the situation. The economists of Europe have however formed juster notions of the potentialities and important effects of the attainment of budgetary equilibrium. The result of the studies of Prof. Rist on this topic has been thus summarised: "the underlying explanation of the facts of inflation and depreciation lies in the budget situation, and that the very possibility of deflation is dependent on the establishment of budget equilibrium.

Granted such an equilibrium, an improvement in exchange will follow of itself, as will a fall in prices. The amount of money is here strictly a resultant."* That is one way of stating the thesis; another and perhaps a better one is that the raising of exchanges and lowering of prices are the common products of the equilibrium of the budget which is the dominant element in the situation.

In the second period 1922-23 there was a further contraction of about six crores. Such a deflation though not important by itself was assisted by the trade recovery and after a time LAG the exchange gradually rose.

A great deal has also been made of the later deflation between the years 1925 and 1927, but it has not always

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* J. W. Angell, Theory of International Prices, pp. 298-299. See also the Quarterly Journal of Economics, Vol. XXXIX, pp. 280-281 and 294.

been remembered that important deductions have to be made from the figures of the gross deflation.* Between October 1925 and May 15, 1927 the net contraction of the note issue has been 32.10 crores. But, when allowance is made for the 13.14 crores of rupees which came back into the reserves, the net contraction is found to be only 18.96 crores. This last figures has to be reduced further on account of the amount of silver rupees which came out of inactive holdings into circulation and which largely exceeded the amount of such rupees which came into the paper currency reserve. On this account a

* The figures are taken from Sir Basil Blackett's statement in an interview on 26th May, 1927. Reference might also be made with advantage to the Report of the Controller of the Currency for 1926-27 pp. 27-28 and for the year 1927-28, pp. 24-25.

further large reduction has to be made from the figure of 18.96 crores in order to get at the net contraction.

As regards this third or post-stabilisation period of deflation, it is a great mistake to believe that in the case of India alone continued stabilisation has required contraction of currency, or that in other countries the stabilisation has been effected at a stroke and no further measures of deflation have been found necessary. In all countries, a good deal of subsequent regulation of currency and credit has been found to be unavoidable. Indeed it could not well have been otherwise; for there were two important factors which necessitated such action. In the first place the adjustment of international prices had to be effectively secured; and further, we are in a period of slowly falling prices all the world over. Both factors rendered deflation inevitable and deflation has accordingly been carried out. But in other countries, the relative importance of credit is greater, and hence the object has been effected to a great extent by a manipulation of the discount rate and restriction of credit. Take for example the case of England. Both English and foreign writers have recognised that since 1925 "artificial" measures have been adopted in order to safeguard the stability of sterling. The Bank of England has repeatedly manipulated the discount rate and sold securities and, even so, voices have been raised for the direct reduction of the fiduciary issue. In other countries, too, the statistics of discount rates bear witness to the contraction of credit. Indeed, there are authorities who doubt whether British prices are not even now too high at least as compared to continental prices. In case of other countries also, like Belgium "the readjustment has not yet been completed."

THE TESTS OF UNDUE DEFLATION

The contention that there has been undue deflation should be judged and appraised in the light of the proper economic tests of such a policy. The steady return of silver rupees from hoards on a large scale for some years succeeding 1924-25 rather shows that such deflation has been substantially counteracted. In the financing of our great staple crops there has been no difficulty, though there must necessarily have been considerable stringency had there been anything like excessive contraction. Then as regards bank rates, apart from certain temporary increases due to the financial strain originating from America, the discount rates of the years following the adoption of the ratio compare quite satisfactorily with those of earlier years. It might be added that the effects of the American situation were not confined to any one country but caused an international trend towards higher rates of interest which has been quite general from South America on the one hand, through Europe and so on to Asia. Indeed a study of the history of bank rates in India and abroad might be recommended to the critics of deflation in India.

We might proceed to consider another test of undue deflation. Is it a fact that in India prices have fallen to a greater extent than in other countries? Such would have certainly been the case had there been such an excessive deflation as has been so often asserted. But the comparative statistics of prices tell a very different tale. Prices in India are at least as steady as in any other country and the tendency towards a decline of prices is if anything less noticeable in India than elsewhere.

FOREIGN EXPERIENCE OF THE NECESSITY OF DEFLATION

The advantage of a timely deflation of the currency and the necessity of attempting a reduction of the war-inflation were best illustrated by the economic history of Japan after 1920. The recent work of Dr. Furuya on "Japan's Foreign Exchange" contains a valuable discussion on this topic. We learn from Dr. Furuya that the inflationist group was particularly strong in Japan and constituted the strength of the political party called the Seiyu-Kai which stood for encouragement of industries and trade by the extension of credit and currency. The fact that the post-war depression came earlier and was sharper in Japan than elsewhere is attributed by Dr. Furuya to the circumstance that the Japanese price level was kept so high. One ministry after another neglected the task of reducing the level of prices and confined their effort to pegging the exchanges and putting an embargo on gold. They satisfied their consciences by attributing the enhancement of prices to the world-wide movement. Such an obstinate policy which was resolved not to deflate in time was responsible, as that author says both for the unfavourable balances of trade and to a large extent for Japan's inability to maintain the market which she had opened up during the war. It was a great object lesson in the advantages of a timely and moderate deflation. It may be permissible to quote one relevant paragraph from Dr.

Furuya's learned and instructive work here :

"The blame, however, should not be borne by one Finance Minister but by his political party, the Seiyu-kai. For the Seiyu-kai always stood for "positive policy" which meant to encourage industries and trade by extending credits, floating-loans, and by passing various governmental measures of all sorts and undertakings. One natural result of such a policy was to swell the state expenditures thereby to enhance prices as already mentioned.

"Thus, when Japan needed an economic readjustment and deflation more than anything else after the War, what she got was the Seiyu-kai's "positive policy" which caused high prices, excess of imports, unfavourable exchanges, and finally exhaustion of gold funds abroad, as they began to peg exchanges in the early parts of

1921 and 1922 by selling gold funds abroad at the government's desired rates of exchange. It is thus known that the government's artificial pegging was an utter failure."

ADJUSTMENT OF PRICES

We now approach the most important issue in the ratio controversy—that relating to the adjustment of prices to the ratio. On this point the statistics of prices and exchanges can be appealed to for a decisive and unambiguous verdict. We have to remember that after August, 1923, there had been no further deflation, and that the trade position in 1924-25 was normal.

The proof of the adjustment of the prices in India to the changes in the ratio is contained in paragraphs 183-187 of the Currency Commission Report, and it is clear and cogent enough to bear summarising as regards its main contention, while it can be strengthened by fuller reference to the conditions and circumstances of the time. We note, in the first place, that the exchanges had been rising very slowly all along the years 1922, 1923 and through the early half of 1924. Meanwhile the prices might be said to have kept fairly steady, ranging from an annual average of 181 in 1921 to 180 in 1922, to 176 in 1923 and to 178 during the year 1924. Two reflections suggest themselves to us here. In the first place, as we have seen, the steadiness of prices shows that the much discussed deflation must have been of a very moderate character in order to result in such a steady price level. We can indeed go further and assert that it was very necessary in the interests of price stability. In the second place, the period of over three years stretching from the middle of 1921 to the last quarter of 1924 might be said to be the required period of time-lag between the rising exchange and price movements. We note further that after August 1923 there was no further deflation of currency. However almost a year after the process of deflation had stopped, and just while the exchange was in the course of rising from 1s. 5d. (sterling) to 1s. 6d. (gold), we find a steep and violent fall of Indian prices which carried them from 181 the index number of prices corresponding to October 1924 to 157 in August 1925. Obviously, it is here that we can trace the action of the steadily rising exchange on the price level; for all factors which were likely to affect prices during the year were of a fairly normal character. The process of deflation had already been terminated full fifteen months ago. The trade position was good, but the large exports were balanced by the "colossal imports of bullion." It was obvious, as the Commission pointed out, that the facts and figures of the period unmistakeably proved a striking and considerable adjustment of prices to exchange. The central and undesirable fact of the period between July 1924 and June 1925 was thus a striking correlation between the rise of the exchange and the fall of prices.

An attempt has however, been made to explain this away by arguing that the fall in prices was the effect not of the rise of exchange but of the alleged fall of world prices. It is therefore necessary to examine this contention. From August 1924 to March 1925, for about six months, there was a considerable fall of prices in India; while in United States of America the prices kept rising till March 1925 and in England they kept rising until after December 1924. This contrast in price movements it is very necessary to bear in mind for, without any question that fall of prices was due to the rise of the exchange in India. It was the exchange position in India which obviously lowered the price level in India even in spite of any sympathetic effect of high prices ruling abroad for some months more. The world fall of prices manifested itself only after the first quarter of 1925; for up to March 1925 prices were rising in U. S. A. In this later period the exchange was stabilised at 1s. 6d., and this factor as well as the reaction of the world prices on Indian prices worked in the same direction. But in view of what took place in the earlier period, there is no reason to ascribe the lion's share of the influence in lowering Indian prices to the latter.

Our conclusion on this point can only be that the fall of prices in India upto March 1925 must be ascribed wholly to the exchange adjustment, and not to any sympathetic action of foreign prices; rather it came about in-spite of the general and high trend of world prices. After March 1925, no doubt, the beginning of the tendency to the decline of world prices needs to be taken into account; but even when dealing with this later period it is well to remember—for one thing—that by that time India had passed through a very large part of her fall of price level; and, in the second place, that this fall in prices in countries like the United States of America was smaller than in India. Obviously, it is impossible to attribute the earlier and the major phenomenon to "the sympathetic effect" of the later and the minor one.

Attention might be drawn in this connection to an excellent study of post-war price movements by Prof. L.

D. Edie of the University of Chicago which has been published recently. He observes that "between the first quarter of 1925 and the middle of 1927 wholesale prices fell, according to various indexes, from 11 to 15 per cent. During the same period, a world wide decline of wholesale prices was under way. In England, this decline was about 17 per cent., and in fourteen leading countries having a gold basis, the average decline was about 12 per cent. The United States set the pace, all other countries had to adjust their gold values to hers. This meant either inflation in United States or deflation outside the United States. Europe hoped for the former, but finally had to face the latter. The outside world was forced to cut under our prices enough to ward off unfavourable trade balances, support foreign exchange rates, and build up credits abroad wherewith to meet international debts."* The above extract will show that in the opinion of a foreign authority on monetary matters the decline of world prices began after the first quarter of the year 1925, *i.e.* several months after the fall of prices in India under the influence of the ratio.

The Commission could naturally discuss the progress of adjustment of prices only up to February 1926. But in the light of later events, the further adjustment of prices to the ratio is rendered very clear. A reference must be made to the table of prices and ratios which has been used by the authors of the Report, which has been quoted and accepted in the dissenting Minutes, and which was expanded and utilised again by Sir Basil Blackett. Bringing the table down to

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* Prof. L. Edie, "Post-war fluctuations in wholesale commodity prices," Quarterly Journal of Economics, March, 1928.

May 1926, *i.e.* a little before the com mission signed its report, Sir Basil was able to demonstrate the existence of a fairly close adjustment. He put the matter in a nutshell thus :—

	Gold parity of rupee.	U. S. A. prices.	Calcutta rupee prices.
December 1922	... 95	156	176
May 1926 ...	... 112	152	150

It was shown on the basis of these figures that the rise in the gold parity of the rupee during the period was accompanied by a very considerable fall in the rupee prices in India, even when allowance is made for any possible sympathetic action of the fall in gold prices abroad.

A comparative study of international prices since 1926 will reinforce our conclusions as regards the adjustment of prices to the ratio. While the course of prices in India has been generally parallel to the movement of prices in the great commercial countries, the fluctuations in the former have been far fewer.

Year	U.K. (Economist)	United States (Bureau of Labour)	India (Official)
1913	100	100	100
1920	283·2	226·2	201
1921	181·0	146·9	178
1922	159·9	148·8	176
1923	162·1	153·7	172
1924	173·9	149·7	173
1925	166·5	158·7	159
1926	152·8	151·1	148
1927	147·9	....	148
1928	....	....	145

From these figures the comparative stability of Indian prices is obvious; and it might be noted that the course of prices in India shows a steady and gentle downward tendency which might be contrasted with the up and down fluctuations in the prices of the other countries. For this comparative stability of prices we are indebted to two factors—the moderate and gradual character of our deflation and the policy of mobility of exchange followed up to the year 1925. The steadiness of Indian prices following the years of deflation—1920-21 and 1923 is noteworthy. At any rate it cannot be inferred from the history of our prices that the deflation in either of these years was any thing but moderate. The fall of prices in the year 1924-25 was due mainly to their adjustment to the ratio.

Such an exceptionally smooth movement and trend of prices and the general correspondence with the slightly downward direction of prices abroad would have been impossible with a ratio which had been ill-adjusted to domestic prices. As we shall see later the adjustment of the general level of prices for imported articles and that for our exports as well as the gradual but sure contraction of the gap between the two sets of prices are also to the credit of a ratio which permits of a continuous and smooth correspondence of relative prices.

AGRICULTURE & THE RATIO.

In the dissenting minute apprehensions were expressed as regards the possible disastrous influence of the ratio on the interests of Indian agriculture, trade and industry. We are now in a suitable position in the light of events of judging the value of such prognostications. Considering the position of agriculture first, we find an entire absence of any possible harm wrought by the ratio. Before coming to study the very limited range of the influence of the exchange factor on the fortunes of the agriculturist in India, we might profitably advert to some much more important world factors which have been affecting agriculture in recent years. We shall find much to learn from the consideration of this broader point of view. It has been observed that in all countries "after a period of war, farm products seem to suffer in a greater degree from the post-war correction of prices. Naturally, as essentials their production has been stimulated during the war, either by bonuses or by price fixing or by the natural advance of prices, and there is a greater inelasticity in the correction of them." That dictum of Prof. Hollander summarises the post-war experience of agriculture almost all over the world. It must be remembered that the rise of the prices of farm products was both in India and in many other countries, generally speaking, a continuation of the slower rise of prices since the late nineties. However, after 1920 America and Europe saw a cataclysmic fall of agricultural prices. The Indian agriculturist was lucky compared to others, since the fall of prices in India was comparatively small and for him the fall was broken by a sequence of four good monsoons. Nevertheless even in

India the level of food grain prices fell temporarily below that of general prices a little later. It is this relative fall of agricultural prices which has caused such a depression in the world's agriculture. It might be noted further that factors like exchange are in no way responsible for this alteration of relative prices to the disadvantage of agriculturist.

We observe further that since the year 1924 (when the ratio of 1s. 6d. was reached) the relative prices have taken a turn in India favourable to the agriculturist. Looking to the statistics of agricultural prices, we find that the Indian agriculturist has even gained ground on the manufacturer in this respect. On the one hand, the general price level has been falling slightly in India since the year 1924; on the other hand as the index number of food grains shows, during the same period, the prices of these most important agricultural products have risen substantially. Since it is the food grains which are of supreme importance to the Indian farmer, we see that the agriculturist has gained considerably by the relative price changes since 1924 when the present rate of exchange was reached. That the Indian agriculturist has done well since the year 1924, as regards food grains which are his chief products, can also be seen from the following figures :

Period.	Cereals.	Pulses.	Cotton manufactures.	Metals.	Other raw and manufactured articles.
1914 (July)	100	100	100	100	100
1915	115	122	97	120	128
1916	106	107	134	186	155
1917	92	96	203	266	183
1918	110	119	298	301	184
1919	163	180	295	236	192
1920	154	166	325	238	231
1921	145	160	280	237	242
1922	137	152	239	175	235
1923	114	112	221	165	207
1924	123	114	229	162	193
1925	136	128	210	131	165
1926	140	149	173	140	141
1927	139	155	159	133	151
1928	133	157	159	125	138

The following observations suggest themselves on a study of these figures, which are of importance both as regards any possible influence of the new ratio on the fortunes of the Indian agriculturist and as regards the condition of the Indian agriculturist during the post-war epoch as compared with that of the agriculturist in other countries. In the first place, we note that the reaction to the inflated war-period prices of agricultural products was, in the case of India, later and less marked than elsewhere. Thus, in the United States, the agricultural prices collapsed in 1920; and it is worth noting that the prices of farm products "fall first, hardest and fartherest." Those who desire further information on the subject might be referred to a valuable article by Mr. A. B. Genung of Cornell University on "the Purchasing Power of the Farmer's dollar" in the Annals of the American Academy of Political and Social Sciences. In India, the fall of agricultural prices was slower and smaller, and became pronounced in 1923. It is further to be noted that in spite of the exaggerations about the deflation in India, the prices of other commodities had not fallen much by that date. Hence we can well call the year 1923, the *nadir* of the fortunes of the Indian agriculturist, since the prices of the main farm products had fallen as far as they were going to during the post-war decennium, while the prices of the commodities which the farmer has to purchase had as yet fallen but little. As Mr. H. A. F. Lindsay has observed in an admirable article on "India's return to normal," so far as the Indian agriculturist is concerned "1923 was his worst year, when the discrepancy between the two (sets of prices) was most marked."

The next thing to be emphasised is that since the year 1923 the Indian agriculturist has been recovering the ground that he had lost. It is of course a coincidence that the Rupee exchange has been also rising from the same date; but it is obvious that the rising exchange and its stabilisation at 1s. 6d. have in no way prejudiced the farmer. For on the one hand the prices of the most important farm products have gone on rising, while, on the other hand, the prices of other commodities which the Indian agriculturist consumes have fallen. It is not for the Indian agriculturist to complain of such a reversal of the course of relative prices to his advantage; nor does he. For since 1923 the prices of cereals have risen by 25 points and those of pulses by 43 points, while he has been gaining considerably on the prices of the commodities which he has to buy.

No better illustration can be brought forward of the crudity of the assertion that the new ratio is going to ruin the farmer.

The fact is that the influence of the change of ratio on the fortunes of the agriculturist is small and indirect compared to that of other greater factors like the cycle of seasons and alterations in the relative prices of agricultural and other products. In the recent ratio controversy, the losses of the cultivators from the rise of the ratio to 1s. 6d. have been placed at fabulous sums which shake rather than support the argument based on them. The change of ratio is alleged by one controversialist to have caused a loss of a hundred crores a year to the Indian agriculturist, while others increase the alleged burden to 200 crores of rupees and even to 250 crores. To complete the tale of wrong, it is added that the agriculturist has lost a few hundred crores more by the fall in the prices of silver which is alleged to be a result of the alteration in our exchange. The resources of our agriculturists must be unlimited, indeed, to have been able to stand all these alleged burdens. Those who made such allegations forgot the adjustment of the prices of the articles purchased by the agriculturists. They also forgot that had the Indian agriculturist been labouring under burdens in any degree approaching those alleged, unmistakable testimony would be borne to the supposed facts not only by statistics of forfeited mortgages, evictions, default in revenue payments and of rise of interests rates but by agrarian disturbances and agricultural conditions in general.

Not only are there no signs of any agricultural troubles such as were both predicated and prophesied, but the verdict of Co-operative statistics can be appealed to in order to demonstrate that under the new ratio, agriculture has been as flourishing as it was under the former ratio. There can be no sort of doubt that the Cooperative agricultural societies, being scattered fairly evenly all over the country, can be taken as representative of the general agricultural conditions. The statistics of such societies are therefore specially useful for testing the conditions of agriculture in general, supplemented as they are by journals edited by numerous and able non-official workers in the co-operative sphere. Now, if the alleged great increase of the burden of the agricultural debt and the material reduction of cultivators' income had been positive facts we would expect to find the following symptoms among others of the disorder: (*a*) the growth of the capital and deposits of the rural societies would have been checked;

(*b*) the proportion of arrears to outstandings would have increased largely; (*c*) loans for unproductive purposes, like repayment of debts would have increased materially; (*d*) the rate of interest on loans would have gone up. As a matter of fact the Co-operative Statistics of the years following 1923-24 show no such adverse symptoms but tell a tale of continued prosperity. They point to a rapid increase not only of the number of societies but of deposits, as well as average capital and general resources. The figures of overdues and arrears show improvement if anything. Nor do we trace any rise either of the interest rates or of unproductive loans. Nor, among the numerous articles contributed by officials and non-officials to the various co-operative journals of India can one find any mention of unfavourable agricultural conditions. Surely, if

Indian agriculture was adversely affected by general factors of currency and exchange, it is not possible that the co-operative section would have alone passed unscathed and even prospered. The matter might be made clearer by a reference to some statistics of agricultural co-operation in India.

Attention might be drawn to the following figures relating to the progress of agricultural societies which show a steady increase of prosperity and resources:

	1923-24	1924-25	1925-26
Total number of Societies ...	54,203	63,873	70,733
Members ...	1,768,220	2,025,058	2,321,959
Share Capital paid up ...	1,85,60,217	2,29,37,715	2,71,79,322
Working Capital	16,55,06,771	19,60,72,982	22,93,46,496
Reserve Fund ...	2,36,54,646	2,88,80,807	3,36,22,092
Profit ...	59,50,643	72,43,475	82,99,708

		1926-27	1927-28
Total number of Societies ...	...	78,538	84,559
Members ...	...	2,615,792	2,870,575
Share Capital paid up ...	...	3,15,12,456	3,60,72,246
Working Capital	...	26,96,00,131	30,09,41,833
Reserve Fund ...	...	3,92,71,284	4,57,66,332
Profit ...	...	94,73,140	1,05,45,785

Some useful inferences can be drawn from the above figures. In the first place, the progress is distributed fairly evenly over the series of years and shows no falling off at any point. We note also the very large increase both in the working capital and what is more, in the share capital paid up. This last factor forms a valuable index of the prosperity of the agriculturist as well as of his power of saving. Even more interesting is the fact that the percentage increase of capital resources and profit is greater than the increase in number of societies and members.

FOREIGN TRADE AND THE RATIO.

There are at least three aspects of the fortunes of Indian foreign trade under the *regime* of the new ratio which deserve careful examination.

In the first place attention might well be directed to the relative movements of the volumes and prices of our export and import trades. We might then observe the course of our balances of trade. Lastly we might consider the fluctuations of some of our leading exports and imports.

I. Coming to deal with the adjustment of the relative volumes and values of our export and import trade we notice that within a quinquennium of the attainment of the new ratio the volume of imports and exports have all but attained their pre-war normal. The course of trade has been well illustrated by the following figures in the Review of Trade of India for 1928-29.

	1913-14	1920-21	1921-22	1922-23	1923-24
Imports ...	183	142	124	138	120
Exports ...	244	172	182	214	240
Total trade in merchandise, excluding re-exports ...	427	314	306	352	360

	1924-25	1925-26	1926-27	1927-28	1928-29
Imports ...	137	143	156	181	190
Exports ...	250	246	228	248	260
Total trade in merchandise, excluding re-exports ...	387	389	384	429	450

The reversion to the pre-war and normal relations of the export and import trades is here strikingly brought out. The import trade had reached its last minimum in 1923-24 and by the time the 1s. 6d. ratio was established in 1926 it had proceeded very materiallv towards its recovery to the pre-war level. Nor has its further recovery been artificially hastened by the new ratio, for the rate of progress of imports remained much the same before as after the advent of the new ratio. There is thus no tangible evidence of any particular bounty to imports. For, while at the present day the volume both of imports and exports is above the pre-war figure it is the export figure which rose in 1927-28 above the figure for 1913-14 and further in 1928-29 at the values of 1913-14 it rose far higher above the latter figure itself. Consequently there is no ground for the idea that the new ratio has kept back our exports. The Review remarks very properly that "the trade figures of the year 1928-29, as calculated on the basis of the declared value of 1913-14, *are a record for both imports and exports. Imports at the values of 1913-14 in 1928-29 surpassed the figure for 1913-14 Similarly exports surpassed the pre-war figure as well as the record figure of 1924-25.* The total trade in merchandise, excluding re-exports was the highest on record." This is surely the *reductio ad absurdum* of the contention that the new ratio has been encouraging imports and hampering our exports.

We shall proceed now to emphasise another equally important point—the adjustment of the general level of prices for the exported and imported articles. It is obvious that a true adjustment of the relative values of our imports and exports is essential for a stable and sound position of our foreign trade. The figures illustrating this process of adjustment are again borrowed from the last Review of Trade:

		1913-14	1920-21	1921-22	1922-23	1923-24
Imports	...	100	237	214	169	190
Exports	...	100	140	127	140	145

		1924-25	1925-26	1926-27	1927-28	1928-29
Imports	...	180	158	148	136	133
Exports	...	154	152	132	130	127

The Review states that "the margin between the import and export prices was identical with the previous year's. Prices of imports and exports declined by about three points each as compared with the preceding year." Such a harmonious movement of export and import prices speaks well for the conditions under which the movements took place. But the matter admits of further consideration and development. If we compare the movements of import and export prices since 1925-26 (the year of the introduction of the 1s. 6d. ratio) we find that the general level of articles *both of export and import has fallen by twenty-five points.* Such a full and exact adjustment of the level of export and import prices indicates a rapid return to the normalcy of economic position of the country. It can be reasonably inferred that the ratio which permits of such smooth and rapid adjustments must be a ratio well adjusted to the economic situation.

It might be added that the problem of the relative volume and values of imports and exports is a far wider problem than that of the ratio and involves a consideration of many other important factors. For one thing, the fact that the decline of prices has been somewhat greater in certain European countries than in India has by itself a tendency to stimulate our imports. Then again, export prices in several countries have been artificially lowered to meet the conditions of industrial and trade depression. All these factors might be expected to lead to an increase of our imports of manufactures. Under such circumstances, if our exchange ratio, had been fixed too high, as has been contended, India would have seen a phenomenal increase of imports. As a matter of fact, however, no such result has followed and this must allay any suspicion regarding our exchange ratio.

II. The statistics of the balances of trade of our country since the inauguration of the new ratio are also of a very satisfactory character. This will be made clear by the figures.

Thus the balance of trade in merchandise was in favour of India to the extent of Rs. 86 crores in 1928-29, as compared with Rs. 82 crores in 1927-28 and Rs. 79 crores in 1926-27. This compares favourably with the pre-war average of 78 crores and the war average of 76 crores. The critics of the new ratio argue fallaciously by taking the figures of the record year 1925-26 as their starting point and in professing to regard the figure of the visible balance of trade for that year as the normal one. So far however was the record of that particular year from being a normal one that its visible balance of trade was far more than double the pre-war average. Indeed the figures of the excess of the *values* of exports for that year are unique in the economic history of India. On the other hand the figures for the year 1928-29 form another sort of record when the total *volume* of import and export trade stand unapproached in the economic history of the country. And the latter record is of a more desirable character of the two since it argues a harmonious and *pari passu* development of both branches of our trade—especially as the *volume, even of the export trade when calculated on the basis of the values of 1913-14 was certainly larger in 1928-29 than that attained either in 1924-25 or 1925-26.* As Taussig has observed: "Let us not fall ,as involuntarily we do, into the deceitful belief, or perhaps the flattering unction, that the sending of goods abroad is in itself a thing which brings money into the country and thereby makes us all more prosperous. Let us hold fast to the fundamental principle that the exports are the means of producing the imports, and that only if there be real effectiveness, real success in the application of our labour and capital, does the country gain." But even the most captious critic of the currency policy of India cannot be dissatisfied when, under it, not only imports but exports make unprecedented records.

In the present controversy much has been made of the fact that in 1924-25 the imports of gold were exceptionally large and have not been maintained at that level, and it has been inferred from it that the purchasing power of important classes in the country has been reduced. The answer might be suggested that the imports of gold in 1924-25 were exceptional and were "due mainly to the large fall in the price consequent upon the rise in the gold value of the rupee and the possibility that this drop in price would be temporary." Allowance has also to be made for growth of the habit of foreign investment in India. Thus even a critic of the new ratio admits that of late "crores of rupees have gone abroad and crores more will follow." It is further only to be expected that if the country buys in any particular year twice or thrice the normal amount of the precious metals, the demand must be temporarily satiated and must fall off to some extent in subsequent years. Imports of gold are influenced by quite a number of causes among which the ratio occupies quite a minor place. Among these factors might be mentioned the present scramble for gold between a great number of countries, the embargo on the export of gold in many countries, the policies of central banks and the course of international loans. In fact the present situation as regards the international distribution of gold is quite an abnormal one. Again if we take the imports of gold and silver together, the average imports since the introduction of the new ratio are quite comparable with the pre-war average. They appear small only when they are compared to the two record years for the import of precious metals viz: 1924-25 and 1925-26 which of course, stand by themselves. Finally, the diversion of the purchasing power from the precious metals to other commodities argues no general reduction of that power. At any rate those who regret the growth of imports cannot also complain of the reduction of the purchasing power of the people.

III. The most important aspect of any study of the course of our foreign trade must consist of an examination of the fluctuations of the main staples of our exports and imports. Among our competitive exports we shall study first the exports of that industry which has complained most of the new ratio. We find that right upto the year 1926-27 the exports of Indian piece-goods went on growing very steadily and that the exports of that year formed our high water-mark in that line. It is only with the approach of the period of the present labour troubles in that industry that these exports decline. A contributory cause of this decline has also been referred to in the last Review of Trade. "As in the previous year the declared values of exported piece goods were higher than those of imported piece-goods and this indicates the principal cause of the retrogression of Indian piece-goods trade in overseas markets." No change of ratio can possibly remedy these two causes of the decline in this line.

Coming to another head of exports, since the year 1924 the total exports of hides and skins have gone on making steady progress throughout the last quinquennium. Our exports of tea can be shown to present an equally satisfactory condition—rising from 340 million lbs. in 1924-25 to 359 millions in 1928-29. It is even more significant that our total exports of oilseeds which amounted to 1,250,000 tons even in the record year 1925-26 have grown to 1,328,000 tons by 1928-29. And that in spite of constantly increasing competition from abroad as well as the growing local consumption which is out-bidding foreign demand.

Even now there are not wanting critics of the ratio who repeat the old fallacy that a high exchange is good for the foreign trade of a country. Such critics ignore the distinction between a *falling* exchange and a *low* exchange, while a falling exchange might help exports a low exchange has no such tendency, for an adjustment of costs and prices to the new ratio is inevitable. A study of post-war balances of trade proves the truth of this proposition and might be recommended to the advocates of a low exchange. The case of France is particularly in point, as many of our advocates of 1s. 4d. ratio have envied France its great fall of exchange. The fact is that while the falling exchange helped the exports of France and contributed to secure the large favourable balances of the years 1926 and 1927, the very low exchange at which stabilisation was effected had no such effect. For the adjustment of prices to the new ratio took places quickly, and the year 1928 (the very year of stabilisation) saw a return of the unfavourable balance of trade in spite of the heavy devalorisation.

There are not however lacking signs that even the critics of the 1s. 6d. ratio have at last seen that it is in vain to appeal against it to the figures of the foreign trade of India. Thus in the

"Capital" of 20th September 1928, Sir Purshotamdas Thakurdas had argued that "the ratio had had an adverse effect on the trade of the country." But speaking before the Legislative Assembly on the 4th March 1929—that is, only six months after, he observed as follows:—"*It is not much good quoting to us figures of foreign trade* and railway returns...... The holding capacity of the cultivators of India is proverbially small. The railway returns can therefore not show a falling off. If industries in India have not been encouraged by an active policy of protection, is there any wonder *that your foreign trade returns have kept up with normal years?*...... Why go only on the foreign trade and the railway returns? The crops if grown, whatever the price may be have to move." Here is at last a full and frank admission that the ratio has had no adverse effect whatever upon our foreign trade. Coming from the author of the Minute of dissent such an open and ingenuous admission is to be specially valued. There are however one or two oversights in it. It is not merely the volume of imports that has attained its tallest record by 1928-29 but also that of the exports. Hence the reference to protection is redundant. Further it is not a fact, as suggested in the speech, that the Indian agriculturist has had to sell his produce at low prices. Taking together the prices of cereals and pulses (in which our agriculturist is mainly interested) a record of high agricultural price was reached by the latter part of the year 1928.

THE RATIO AND INDUSTRIES

The four years that have elapsed since the inauguration of the new ratio have naturally cleared many of the issues in our currency controversy. For one thing it is now evident that the position of the Indian agriculturist has in no way been adversely affected. Nor, as we have just seen, are the figures of our foreign trade such as to shake our confidence in the ratio. There remains only the argument that the industries of the country are depressed on account of the ratio. In considering this aspect of the controversy attention might well be directed in the main to the piece-goods industry which is alleged to have suffered most grievously owing to the ratio. It is one of the representative industries of the country and has a high claim to the anxious solicitude of all Indians. If, indeed, the depressed condition of this industry is in any tangible measure due to the ratio there is a heavy count against the currency policy.

In studying the affairs of the industry the verdicts of two economic and technical inquiries which have been recently conducted with regard to it are entitled to due consideration. Thus, before the Indian Tariff Board Sir P. Thakurdas, the late Mr. B. F. Madon and others strongly advocated the view that the depression in the industry was due to the factor of exchange. As Mr. Madon put it "the real difficulty is the twisting up of costs and charges through exchange manipulation," Sir Purshotamdas also gave to "the mismanagement of the Indian currenry" the foremost place among the factors of depression special to India. After a searching inquiry, however, the Cotton Tariff Board arrived at the conclusion that the stabilisation of the rupee at 1s. 6d. was only "a temporary handicap imposed on the industry." That its importance was but small might be inferred from the Cotton Board's dictum that they "should have had considerable hesitation in proposing an increase of import duty on this ground alone"—even "a small increase, all-round increase", be it noted. The additional protection proposed by the Cotton Tariff Board was based on the ground of unfair competition from Japan and was "justified for such period as the labour conditions in Japan continue inferior to those in India."

The other inquiry has been conducted by Mr. G. S. Hardy (Collector of Customs, Calcutta) in the year 1929. He shows by a consideration of the statistics of the industry, how little of its troubles can be justly attributed to the 1s. 6d. ratio. The following extract from his report will make the matter clear. "While the Bombay millowners have insistently attributed a large part of their troubles to the fixation of the rupee at 1s. 6d. it is significant that whereas their gross output remained stationary during the three years 1921-22 to 1923-24 in which the rupee was pursuing a fluctuating but upward course, their output again began to rise steadily as soon as exchange was settled in the neighbourhood of 1s. 6d. In fact while the output of the Bombay mills rose from 856 milyards in 1923-24 to 1135 in 1926-27 and fell, owing to labour troubles to 1131 and 537 in the next two years, the output of other Indian mills rose from 847 milyards in 1923-24 to no less than 1356 milyards in 1928-29, an increase of 60 per cent. in 5 years." He adds that "under almost every head there has been steady progress upto the year 1927-28."

Mr. Hardy's view is supported by the figures for the exports of piece-goods from India which continued to increase after the introduction of the new ratio. The chief factor in their recent decline consists of the higher prices of our exports. Mr. Hardy has also shown that the severity of external competition has very recently increased in a few well defined classes of grey and coloured goods coming from a particular country or countries. Had the severity of competition been due to a perfectly general cause like the currency policy or the ratio, the increased competition would have been felt over piece-goods generally and would not have been confined to a few particular classes of piece-goods like grey shirtings, printed drills and woven twills from Japan and printed flanellettes and twills from Italy. As Mr. Hardy remarks, "imports of these have quite recently increased very rapidly and the prices at which they are sold are surprisingly low." Any adverse effects from the ratio or the currency policy cannot possibly concentrate themselves on a few isolated groups of piece-goods. Take again the figures for imports into Bombay itself during the last few months. During the months of April to October (1929) the imports into Bombay of cotton grey piece-goods increased in value by 91.1/4 lakhs. But as Sir F. Sykes pointed out in his recent speech to the Chamber of Commerce this was more than counterbalanced by a much greater decrease in the arrival of white and coloured cotton piece-goods. Taking a wider view and looking at the general figures of such imports into India since 1924-25 we notice that there has been a decline in the imports of grey goods, a great increase in coloured goods and little change in the white trade. It would be very difficult to explain such varied phenomena in the light of the popular theory that the new ratio gives a bounty to imports in general. It is also noteworthy that both in Ahmedabad and on the Madras side quite a number of new mills are under construction. The cotton mills of the Madras Presidency have again had a normal year.

The opinions held by representative mill-owners and experts regarding the influence of the ratio upon their industry will repay a careful study. Both Sir Victor Sassoon (in his evidence before the Royal Currency Commission) and Sir Purshotamdas Thakurdas (arguing before the Textile Tariff Board) have urged that the principal way in which the 1s. 6d. rupee hits the mill industry is by undermining the purchasing power of the agriculturists. But, as we have seen, the statistics both of agricultural prices and of imports lend no support to this view. The prices of the main products of Indian agriculture have been steadily rising while the prices of the articles which he largely consumes have been falling. It is obvious then that the purchasing power of agriculturists has been on the increase. This is supported also by the phenomenal increase of the output of Indian mills (outside Bombay) by no less than 60 per cent. in the five years ending in 1928-29 as also by the course of piece-goods and other imports.

In the year 1925, Sir Victor Sassoon, representing the Bombay Millowners' Association informed the Royal Currency Commission that $3\frac{1}{2}$ per cent represented the difference made to the textile industry by the rise of the ratio from 1s. 4d. to 1s. 6d. He observed as follows: "I have worked out the difference between the present 1s. 6d. rate and 1s. 4d. rate as a very little less than the excise. So to-day with the excise removed, all we are getting is, I think, a ·03 per cent advantage over what we would have had if the excise had been left on and we had our 1s. 4d. gold as we had last year". The obvious inference is that whatever adverse effect was supposed to have been produced by the rise to 1s. 6d. was substantially counteracted by the removal of the excise. The figures put forward by Sir Victor Sassoon regarding the maximum burden which could possibly have been imposed on the cotton industry by the new ratio were corroborated by the statement of another Bombay expert before the Currency Commission that there had been adjustment to the ratio regarding 67 per cent of the cost of production in that industry. For 60 per cent of its cost of production is the cost of cotton while another 7 per cent of its cost of production represents the cost of imported stores and machinery. When these views expressed before the Currency Commission by eminent experts like Sir V. Sassoon were put to the leading critics of the ratio before the Textile Tariff Board there was no attempt either to refute them or to put forward any other figures. So they might be expected still to hold the field.

But the truth is that the depression in our textile industry is due to a multiplicity of factors which have little to do with the exchange. It is a suicidal policy to harp on the ratio and to try to divert attention from the really important factors in the situation. Amongst these latter might be mentioned the growth of textile industries in Japan and other competing countries which are backed up by magnificent buying, selling and financial organizations. It is not merely that the manufacturing power of our competitiors has increased during and since the war, but the whole organization of their industries has been improved in every direction. The superior organizing power of the Japanese manufacturers is also seen in the various ways in which they have worked to offset the reduction of hours of labour and the prohibition of night-work for women and children. On this topic a reference might be invited to a valuable article by Orchard in the Political Science Quarterly for June 1929. On the other hand in India we have not overhauled our industrial organization in the line for many years. Then again it is quite likely that the world in general and India in particular has been witnessing for some years an over-production of coarse cloth, and this is supported by the growing manufacture of such cloth abroad as well as by the increase by mills out of Bombay of their output by nearly 60 per cent. in five years. Deprived of its yarn trade with China our mills have to produce more and more coarse cloth and to force the sales of this increasing mass of production. Even when we come to apply protection as a remedy for this state of things it will have to be applied in the right direction and very tactfully. For protection is bound to raise the price of our cloth and hence to reduce sales in India. Abundant experience has shown how elastic the Indian demand for piece-goods is. Consequently the use of protection will by itself have no very great or lasting effect on the fortunes of the industry unless we have a simultaneous introduction of that "rationalisation of managing control" upon which Sir F. Sykes has recently laid so much stress. For more than a decade the cotton industry has been exhorted by its best well-wishers and advisers to overhaul its organisation and methods, and the need for such a procedure is the more pressing now, since in the post-war epoch all our rivals from Lancashire to Japan have conducted great economy campaigns and have improved their organization and capitalization. That the chief rival of our cotton industry is fully alive to the need for constant improvement in organization is obvious. This is emphasised by Dr. Shuichi Harada in his recent work on "Labour conditions in Japan" that "the application of high-grade labour-saving devices, large scale production and the adoption of scientific management have achieved for the cotton industry the largest and the most representative place in Japan." Since the war there is proceeding a great race between industrial countries for improved organization and reduced costs of production; and we must join in it whether we would or no. It is no good arguing as was done before the Cotton Tariff Board that no improvement in organisation is necessary in India for "our mills were able to do well in the pre-war days under similar conditions of organisation." For much water has run under the bridges since then, and great advances have been made in textile organization abroad.

In this connection a quotation might be permitted from a recent article of the leading daily of Western India which has shown itself to be a hearty sympathiser with as well as excellent adviser of our textile industry :—

"Cut your costs is the industrial slogan of the day, but costs must be cut not by the curtailment of wages but by better and more efficient output, selling and distribution. The lessons of the West cannot be ignored in this country, where an important national manufacturing concern like the cotton textile industry is in the depths of depression. High import duties are merely a palliative destined to throw a burden on the consumer, who is ill able to bear it. While the Bombay mills deserve protection against the crippling competition of Japan, the interests of the public demand from the mill-owners an assurance that their costs have been cut to the bare minimum, that their management is efficient and their selling organisation effective; in short, that the principles of rationalisation are being applied to the industry."

But while good results can certainly be achieved by a judiciously directed policy of protection, there is nothing whatever to gain by an alteration of the ratio. Indeed, it is not difficult to show that a reversion to the former

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* *The Times of India*, 23rd January, 1930.

ratio under the present circumstances is to be avoided in the very interests of industry in general and of the cotton industry in particular. Amidst the present tension between capital and labour such an alteration of the ratio would cast a new bone of contention between the parties and would bring about a fresh epidemic of strikes all over the country. In its present mood, labour is not at all likely to be content with its present wages when general prices rise $12\frac{1}{2}$ per cent. as the result of the lowering of the exchange. Labour would in fact at once assume that profits of industry in general had arisen permanently by $12\frac{1}{2}$ per cent. and would put in a claim for a similar rise of wages. It could quote our industrialists and critics of the ratio against themselves—and with perfect justification. They would be incessantly reminded that they had prophesied complete prosperity and large profits for the industry, an immense increase in the purchasing power of the consumer and the removal of serious handicaps of the industry as the result of the change in the ratio. They would be held to all their promises, and labour would proceed to exact the full pound of flesh from them.

It is a mistake to think that it is only a period of falling prices which is favourable to epidemics of strikes. Those who believe this half-truth have not fully studied the history of strikes before the war. In a meritorious work on. "Monetary Stability" Mr. Bellerby has given a full statistical account of the course of strikes during period of rising prices. After a statistical correlation of strikes and rising prices he observes: "It is to be seen from the above figures that the period of trade boom and crisis about the year 1907 was accompanied by a pronounced increase in the number of trade disputes. This increase was, however, of minor importance compared with the bigger swelling movement from 1911 to 1913—a period which followed a gradual rise of some 10 per cent. in the price level and the cost of living. From this it would seem at the outset that a long-period movement in the level of prices—no matter how gradual—is equally detrimental to industrial relations as the more brusque movement associated with the trade cycle." He concludes by noting that "an upward trend of prices, by causing a corresponding increase in living expenses, leads inevitably to demands for higher wages, arising in circumstances which make for distrust and resentment rather than for amicable agreement. A serious outburst of industrial disputes almost invariably ensues." The gain from the change in the ratio would be a merely temporary matter until new adjustments are effected. But the expectations aroused from the step are so great that the rapid rise of money wages, which the raising of the ratio has helped to check for the time being, will be sure to resume its march and will inflict a new and permanent burden upon industry. The result of the recent Ahmedabad Mill dispute and the increase in wages awarded by the umpire in that affair should serve as a warning that labour is on the alert for any chances of increase in wages, and that it will make the most of a chance like the alteration of the ratio. Any gain to our industrialists from the change of the ratio is bound to be temporary and partial while the demand for the raising of wages will be a permanent and general one. The question has been often asked whether our wages have adjusted themselves to the higher ratio. The best answer to that question will come when money wages resume their upward progress with a reversion to the former ratio.

In conclusion it might be pointed out that since the year 1925-26 Indian export and import trade has made new records, the internal price-level has been as steady as in any other country, while the tendency towards a return to normal conditions has manifested itself unmistakeably in quite a number of directions. Among these might be mentioned the balances of trade, the relative prices of agricultural and other products and the adjustment of the general levels of the prices of imports and exports. In spite of these undeniable facts there is no end to the devising of new arguments against the ratio. For, as has been remarked in the latest text book of Indian Economics written by the well-known Indian professors Jathar and Beri "the new ratio will be made answerable for every kind of misfortune and it bids fair to take its rank along with the drain theory as an all-sufficient explanation for every conceivable evil." In this spirit attempts have been made to hold the ratio responsible for the recent rise of the bank rate. If, however, the critics had studied the matter comprehensively and carefully, and had compared the money-rates in India with those prevailing in other leading countries since the year 1923 or 1924, they would have seen that there was no reason to suspect any special tendency towards the rise of such rates in the case of our country. And, as to the rise of the rates on certain occasions during the last year, they were a result of the growing monetary strain in the world. The financial strain was tremendous in all the leading countries. Several European central banks lost more gold from their reserves than they could really afford; quite a number of countries placed an embargo upon gold shipments to resist the drain of funds to America; and the rise of bank-rates was a world-wide phenomenon. The extraordinary drain of funds from all countries to America was exaggerated by the American policy of interning the gold as it arrived. Meanwhile for the rest of the great commercial countries the choice lay between either exporting gold or raising their bank-rate. Like other such nations India too made her choice and raised the bank rate. There is no denying that high bank rates are a burden to trade and industry. But the rise of the bank rates in India during the last twelve months was only a result of the general financial strain in the world, and it has no relevance whatever to the ratio question in India. Its only lesson for India is the necessity of establishing a Reserve Bank as soon as possible.
