AN EXAMINATION
OF THE
CURRENCY COMMISSION REPORT

BY
P. B. JUNNARKAR, M. A.; LL. B.
READER AND HEAD OF THE DEPARTMENT OF COMMERCE,
DACCA UNIVERSITY, THE AUTHOR OF
'THE RUPEE AND THE GOLD STANDARD'.

1926

[*Price Re. 1. as. 4*
or 1s. 8d.

PUBLISHED BY THE AUTHOR
Tikatooly, Dacca.

PRINTED BY J. C. DAS
AT THE
Associated Printing & Publishing Co., Ltd.
40, Kaltabazar, Dacca.

To

K. L. E.

E. M.

FOREWORD.

The author must apologise to the public for encroaching again upon their patience. But the Indian monetary question has acquired outstanding importance, since the publication of the reform proposals by the currency commission; and it is necessary to define the main issues clearly for a satisfactory solution of the problem. This is the more necessary on account of the unhappy knack which both officials and their critics would appear to possess for vague generalisation. This is peculiarly so with reference to the proposal for a new Reserve Bank.

The interest of the author in the subject is purely scientific. He has no preference, sentimental or otherwise, for any particular position.

At present, a species of warfare would appear to be going on between Bombay and Delhi. While it is not possible to pronounce upon the merits of either sides, it is necessary to warn both that decisions arrived at in heat are not likely to be sound. If Bombay's claim to understand the true interests of India is disputable, the claim of Delhi is equally so. Real India must cast off its torpor in its interests and call a halt to this unseemly controversy.

In the recent speech before the Delhi University, the Finance Member repeats his insistence that the 1/6 level is in the true interests of India. But this was no more than a riposte in fence against 'that good agriculturist Sir Victor Sasoon,' on account of his "Currency League" activities While, a level of exchange as such, for or against the interests of a country may be a disputable proposition, what requires an impartial examination is the tendency *as a whole*, of a particular monetary policy in the interests of India, the level of exchange being only one and the least important aspect of the policy. From this point of view, an emphatic warning is necessary that the diagnosis of the Finance Member of the 'abnormal ease' in the Money Market is wrong. The 'tight screw' policy in the past consisted in no more than 'placing strict limits on possibilities of expansion.' This is now replaced by a policy of active contraction which must hasten the financial disaster—the present abnormal money situation being only a stage--for which India is heading. The greatest service which the Finance Member can render to India is to leave exchange alone and to bend his energies to restore 'normalcy' to the Indian economic system. A temporary disturbance in his financial equilibrium is a small price to pay for correcting the economic disequilibrium of a country, especially as all the carefully prepared plans even for objects such as remissions of provincial contributions must go by the board in the storm of which there are portents. India has, at present, need of men with clear vision, who can think courageously and act courageously in the economic and political sphere. There can be no test of courage truer than that of being able to revise opinions and to resist the instinct to defend a commitment merely because it happened to have been made.

Dacca, 27th Nov. 1926.

CONTENTS

	Page
The Enquiry by the Commission	1
The Ratio of Stabilisation	3
Domestic Adjustments	9
Artificial Appreciation of the Rupee	24
Abnormal Money Market	26
Industrial Securities	29
Size of reserves	35
The Gold Bullion Standard	41
The silver note and the paper note	43
The gold savings certificates	47
The buying and selling rates for gold	54
A modified scheme	57
A Central Bank for India	60
The Imperial Bank	63
The American system	65
The State Banking System	68
The National Banking System	68
The National Monetary Commission	71
The Glass Committee	74
'Federal' versus 'Central'	75
The Minimum Reserve Requirement	77
The Protest of Canadian Banks	79
Direct Dealings with the public	81
Failure of the American system	82
South African Experience	84
Three main types of banking systems	85
Indian banking development	85
The special place of the Imperial Bank	87
Indigenous banking system	88
Development of *rediscount* business	92
Reform of note issue and convertibility	92
Growth of deposit banking dependent thereon	94
Principal functions of a Central Bank	96
Competition with other banks	98
Appendix A—Mr. Keynes' scheme	101
Appendix B—the Imperial Bank, Constitution	106
Appendix C—the memorandum submitted to the currency commission.	110

AN EXAMINATION

OF THE

CURRENCY COMMISSION REPORT.

The report of the Royal Commission on Indian Currency and Finance was published on the 4th August 1926 and had a mixed reception as might have been expected under the circumstances. The majority Report has been hailed with delight by a section of the community on the unassailable ground that the currency wisdom it desplays coincides so much with their own and the dissenting minute has commended itself to another section of the community whose antagonism will not see any merit in the proposals of the majority even though some of the most important recommendations embodied in these have been subscribed to by the author of the dissenting minute.

The appointment of the commission, however, was unfortunately timed, its personnel lent itself to criticism and important conditions necessary for an impartial investigation were absent.

Thus, on the one hand, the Finance Member urged the necessity of 'close cooperation between the

Government and the commercial and business community', so that 'a right judgment can be reached and right action taken in a matter affecting the commercial and business life of the country',[1]—while forecasting a commission, a premature appointment of which the Associated Chambers at least had deprecated by resolutions passed for two years in succession, he considered it necessary to speak with caution about the exchange policy in view of the projected inquiry and threw his caution to the winds by a simultaneous declaration that no sanctity was to be attached to the pre-war ratio, thus taking an important decision off hand on his own responsibility and indicating his scarcely veiled preference for the 1/6 ratio.[2]

On the other hand, a representative of an influential chamber of commerce, while leading evidence before a tribunal presiding over an enquiry needing all the judicial balance that could be given to it, would appear to have prefaced his statement by declaring his want of faith in the personnel with the exception of one member,[3] calling forth an angry outburst from the Chairman ordering the deletion of the offending sentence from the record.

1 Speech to Associated chambers, December 1923.

2 The speech, 3rd July 1925.

3 Note further the unusual procedure of answering the minute of dissent of this member in the particular tone adopted.

And yet there never was a problem for which a different atmosphere was more necessary, especially as the problem was complicated by extraordinary issues. The proposals of the commission need, therefore, to be subjected to a rigorous scrutiny. The main proposals fall under three heads, I.—the ratio of stabilisation, II.—the gold bullion standard scheme, and III.—a central bank for India.

I.—THE RATIO OF STABILISATION.

The most courageous step would have been to leave the rupee alone for a period of two years, while making adequate provision for the expansion of currency to meet the normal requirements of commerce.[1] As it is formulated the scheme will require five years before it can be given effect to in its important details. India has waited so long for a sound monetary system and could afford to wait a little longer provided there is an assurance that she would be definitely rescued from the quick-sands of uncertain exchange experiments and would be set firmly on her currency feet for future progress. Now at least she might have been spared the uncertainty that the 1/6 ratio introduces in the prospects of a transition to a true gold standard

1 For measures to be adopted in the transitory period, see the memorandum printed at the end.

specially as the success of this transition depends more than anything else on her reserves remaining unimpaired in their strength.

Indeed the majority begin their report[1] by describing, as a matter of course, the 'existing' system, in the following terms, "The value of both forms of token currency in relation to sterling is at present being maintained between the gold points corresponding to a gold parity of 1*s.* 6*d.* No obligation has been assumed, but the Government as currency authority have freely purchased sterling when the rate has stood at 1*s.* $6\frac{3}{16}d.$ and recently in April 1926 authorised the Imperial Bank to make an offer on their behalf to sell sterling at 1*s.* $5\frac{3}{4}d.$ The stability of the gold value of the rupee is thus based upon nothing more substantial than a policy of the Government, and at present that policy can be found in no notification or undertaking by the Government," and do not even pause to enquire how such a policy came to be framed at all, in view of the necessity of 'close cooperation between the Government and the commercial and business community' considered indispensable by the spokesman of the Government. The mercantile community whether European or Indian appear to have been under the only impression that while

1 Para, 11.

the recommendations of the Smith Committee were definitely shelved, the further policy would be framed by another commission and that they would have a full hearing in the formulation of such a policy. Indeed the Calcutta opinion appeared to take the view that the appointment of the commission was premature and that 'it would be unnecessarily disturbing to trade for a commission to be deliberating on the question of exchange, while *the mercantile community themselves were undecided as to what system or policy was really needed*'.[1]

Assuming, however, that the decision to give immediate effect to the 1/6 ratio to be not unwise, ordinary prudence would have suggested the necessity of leaving some door open for future adjustment should the rupee show a tendency to recede to a lower level. There is nothing in the trade position of India which would justify her currency unit in maintaining the unique distinction of being the only monetary unit commanding among the the currencies of the world a premium of 12½ p. c. above the normal pre-war parity. Such a position, by itself, would suggest some abnormal development in her trade or otherwise a currency manipulation having forced it to an artificial level.

---

1 The money market review, *the Statesman*, 20th September 1925.

Common sense would suggest that the position was unsafe in either case.

This hasty decision, however, is probably in consequence of an entirely erroneous attitude on the part of the commissioners who viewed the issue simply as the one between the 1/6 ratio and an *artificial reversion*[1] to the 1/4 ratio. If the latter alternative would have been wrong, it does not follow that the first was right. And yet this is how the whole question appears to have been argued.

The result is to invest the decision of the commission with an air of excessive confidence ; while the case *against* the 1/6 ratio does not appear to have been adequately examined. Even among the advocates of the 1/6 ratio, many including the most influential and important chamber of commerce in Bengal had hesitated to be dogmatic.

The grave objection to the 1/6 ratio is that it has come into existence under artificial conditions produced by a definite monetary policy pursued by the Government of India. Whether the policy deserves condemnation or praise may not be immediately to the point. If this policy, however, has resulted in an artificial level of exchange it is important that it should be reversed to enable the

---

* Even this objection has lost its force since the artificial interference in April 1926 to prevent a natural adjustment.

rupee to find its natural level *whatever this may be*, before further building is done on what may prove to be an unstable foundation.

If only the Indian Government would heed it, the March—April crisis of 1926 provides a warning as to what may be in store for them in the transitory period of five years during which they will remain the currency authority.

That the fall in exchange was exaggerated by speculative rumours does not alter the fact that a definite weakness in exchange had developed indicating a lack of confidence in the 1/6 level. The sag in exchange was the more inexcusable as there was no question of an unfavourable trade balance. If such a situation can develop in an ordinary year, the threat that an actual unfavourable trade balance holds is too serious to be set aside as of no account.

That the Government intervened to prevent the rise above $1/6\frac{3}{16}$ and were therefore justified in their intervention to prevent the fall below $1/5\frac{3}{4}$ is hardly to the point. One mistake constitutes no justification for another. Indefensible as either intervention to prevent mere exchange fluctuations would be, what was wrong was the policy *at the bottom* which brought about such an erratic rise, holding the perpetual menace of a fall.

The March—April crisis[1] if nothing else, has brought out the essential nature of this unsound monetary policy, namely, the currency supply must be manipulated solely with reference to the exchange rate.

Instead, however, of enquiring closely into the circumstances of this rise, the commissioners content themselves with the assertion[2] that *if* it can be shown that prices have to a preponderant degree adjusted themselves to the existing *de facto* rate, then that rate must be adhered to. This statement might hold good if the rate of exchange had been left to the free play of economic forces. And even then, the rate of exchange must be shown to have been reflected in internal prices of *both commodities and services*.[3]

---

1 Commenting on this, the *Statist* remarked, "It would be idle to pretend that in thus intervening in support of the rupee the Government of India were not anticipating the recommendations of the commission or giving the commission a straight hint as to the rate they should recommend for stabilisation. There seems, indeed, strong ground for the belief that, had it not been for the Government's action, the open market exchange would have sunk to a rate that would probably impel the commission to recommend the old parity of 1*s*. 4*d*. for the rupee.

2 Para 177.

3 Prof. Cassel states his 'purchasing power parity' doctrine in this form, "Our willingness to pay a certain price for a foreign money must ultimately and essentially depend on the fact that this money has a purchasing power as against *commodities and services* in the

Indeed the three main considerations in fixing a particular ratio, as suggested by Mr. Benjamin Strong, Governor of the Federal Reserve Bank of New York,[1] ought to be, (i) the domestic adjustments to a given price of the rupee ; (ii) the extent to which any artificiality has entered into the management of the external price ; (iii) the size of reserves.

(i) THE DOMESTIC ADJUSTMENTS.

From these three, the only consideration which appears to have received any attention is the first. The treatment, however, is perfunctory, and arguments have been built up on a series of assumptions unproved and unprovable.

This commission fully sustains the tradition of currency commissions in the past, of laying down admirable principles and running away from them the moment they have to be applied practically.

Thus they recognise,[2] that index figures are not an infallible guide ; that they are more re-

---

foreign country. On the other hand, when we offer so and so much of our own money, we offer, in fact, a purchasing power against *commodities and services* in our own country. Our valuation of a foreign money will, therefore, essentially depend on the relative purchasing power of the currencies of both countries".

1 Minute of Dissent, Para 77.

2 Paras 178, 179, 180.

liable 'in indicating the general trend of prices in each particular country than in comparing the relative level of prices in two or more countries'; that quite apart from the imperfections of the Indian figures of prices, the employment of index numbers for determining the exchange ratio implies the important assumption that changes in the prices of goods entering international trade have been followed by similar changes in the prices of all other goods; that in India there are special difficulties in the way of compiling a representative index figure owing on the one hand to the great size of the country and the cost of inland transport and on the other to defects in the statistics on which the compilation is based,—indeed they regard these defects so serious that they recommend that 'a serious and sustained attempt should be made to remedy these and to lay the basis of sound economic deductions by the collection of accurate statistics not only of prices, but also, of wages, a subject which in India presents even greater difficulties.'

In spite of this, the commissioners proceed to to make a series of deductions which they not only themselves consider sound but which they regard a 'conclusive answer' to those who doubt that a substantial adjustment in prices and wages has yet taken place. Thus they dispose of wages by a vague generalisation that considerable progress in such an adjustment may be assumed to have taken place on general grounds[1]; they would regard Calcutta and Bombay indices to be representative of India; they have actually *compared* with other countries, the price level based on these, tacitly assuming this to be equivalent to the all India price level, comparison by means of a graph concealing the arithmetical comparison implied therein; and for the purpose they have made use of the available index figures in a manner which renders the comparison futile.

Thus the Indian index numbers are simple arithmetic averages of price relatives; the Bureau of Labor index number[2] for the United States of America is constructed by what Walsh would call Laspeyres' Method, involving a comparison of the weighted *aggregates* of prices, the weights used being the base year quantities marketed; while the Board of Trade index number[3] for England is the simple Geometric average of the price relatives. Each index number proceeds upon a different principle in its construction.

---

1 Para, 192.

2 Fisher, *The Making of Index Numbers*, p. 59.

3 *The Making of Index numbers* p. 435.

About the simple arithmetic, Professor Fisher in his book[1] remarks, "In fields other than index numbers it is often the best form of average to use. But we shall see that the simple arithmetic average produces one of the very worst of index numbers. And if this book has no other effect than to lead to the total abandonment of the simple arithmetic type of index number, it will have served a useful purpose."

Nor is this an academic objection proceeding from a mere theorist. Professor Fisher has actually taken 36 commodities and by their price quotations has put to a rigorous scrutiny all available methods of constructing index numbers.

One of the tests he applies is the Time Reversal Test which simply means that the formula for calculating an index number should be such that it will give the same ratio between one point of comparison and the other point *no matter which of the two is taken as the base.* Thus for instance if the index number for a given year shows that the price level for that year is *twice* that of the base year, an index number calculated backwards for the base year, with reference to the given year as the base, *must* show that the price level for the base year is *half* that of the given

1 p. 29.

year, or generally the backward index number must be the reciprocal of the forward index number.

Applying this simple test to the arithmetic index number, he comes to this extraordinary result, "We find that the simple arithmetic index number of the 36 commodities makes out the price level of 1915 to be 1$\frac{3}{8}$ per cent higher than that of 1914 with 1914 as the base while, reversely, it makes out the price level of 1914 to be $\frac{1}{2}$ per cent higher than that of 1915 with 1915 as the base. In other words here is an actual case where each of two years is represented by the arithmetic index number as being higher priced than the other !"[1]

It ought to be obvious that any comparison would be extremely dangerous with the aid of such materials ; and yet such a comparison has been made the basis of the entire argument about the price adjustments having been completed.

In a graphical representation the *slope* of a plotted line depends entirely upon the magnitude of the ordinates. Indeed the main use of diagrams is to present groups of figures so that they shall be intelligible in their entirety, and the test for all diagrams is that the diagram as drawn should afford the best view of the series or a group of

1 *The Making of Index numbers*, p. 67.

figures that the eye can appreciate. But the object is the comparison of those figures, the diagrams being auxiliary rather than essential, merely an aid to the eye and a means of saving time.[1]

Index figures have a limited use in indicating the general *trend* of prices in each particular country. This only means that it would be possible to say generally from index numbers whether the tendency for prices in a particular country is to rise or to fall.

Indeed the entire argument in the Report is vitiated by a confusion between this obvious meaning of the word 'trend,' and the 'trend' of the plotted lines in the diagrams. The 'direction' and 'slopes' in a graphical representation depend upon the magnitude of ordinates, involving a quantitative comparison of the rise and fall of price levels in different countries.

Unmeaning as such a comparison would be, the manner in which the figure of the world price level has been arrived at, is not trustworthy. Even between England and the United States of America, index numbers known to be constructed on different principles cannot be used with safety for comparison of the price levels of two different countries. Unjustifiable as such a use would be

1 Bowley, *Elements of Statistics* p. 143.

on simple grounds, to construct a hybrid index number from the two by an average—it would be interesting to enquire what average was used—is a procedure in which even the magic 'authority' of the commission must fail to inspire confidence.

Fig. 2, particularly, in the Report,[1] may be cited as a curious example of misuse of the graphical application of the statistical method. The diagram is intended to convey the correspondence between the rise of the rupee-exchange and the fall of rupee-prices, on the strength of the parallel course of the plotted lines representing them. If it is noted that the figures for the rupee exchange are in 'pence' and those for the price level are in 'points' of the index number, it will be realised that most misleading results can be obtained by varying the scale of either in the diagram. Indeed the particular choice[2] of the scales in the Figure, though not intentional, is calculated to *produce* the correspondence sought to be established.

It is for this reason that Bowley has given a warning against the use of diagrams dealing with different sets of figures in order to *prove* some relation between them.[3]

1 p. 71.

2 I inch = about 2*d*. 1 inch = about 15 points.

3 *Elements of Statistics* p. 173. For the care to be exercised in the choice of scales read pp. 168—177.

A comparison[1] between two sets of figures may sometimes be possible by reducing them to percentages of their value in a given period. Reducing the rupee exchange and the rupee prices to percentages of their value in July 1922, we get the following figures :—

		The Rupee Exchange (Gold.)	The Rupee Prices. Calcutta and Bombay).
July	1922	100	100
December	1922	104	94
June	1924	105	97
July	1924	106	97
August	1924	113	98
June	1925	127	85
February	1926	127	83

Thus till February 1926, while the rupee rose 27 points in the exchange market, the price level fell 17 points. If it is realised that a part of this fall is due to the general fall of gold prices which is expected to continue, the general adjustment of prices to the 1/6 level must be admitted to be still due and will further aggravate the distress of Indian industries.

This argument, however proceeds upon an important assumption, viz., Calcutta and Bombay

1 In the present instance, even such a comparison between a rate of exchange and *one* price level is wrong in principle.

indices represent the all India price level. The considerable disparity which is to be found now and then in the movement of these two indices themselves in the past would suggest caution against such an assumption. Though India's foreign trade in the absolute may be large, it bears a small proportion to the extensive internal trade. With the immense distances and isolated markets, the response of the internal level of prices in India to changes in the world price level is necessarily slow.

Nor is it possible to speak of the world price level in terms of a single index number. If the available index numbers of important countries in the world are examined,[1] it may be possible generally to say that the tendency of the price level in all the countries with obvious exceptions like France would appear to be downward, indicating the general and continuing appreciation of gold in terms of goods, and with reference to the dollar and sterling a limited conclusion may at the most be hazarded that probably the relative position of the rupee with regard to these currencies is unaltered,—which would point to 1/4 as the normal level of the rupee. Standing alone, even such a limited conclusion would be unwarranted.

---

1 See Table facing this page.

Unsatisfactory as the argument is about the price adjustments having been completed, the report further proceeds to take for granted that as the price adjustment had been completed, considerable progress has been made in the wages adjustment,[1] thus drawing an inference from an unproved premiss, ignoring all available definite evidence against such a conclusion. It is a common place of the economic history of all countries that while wages may rise with rising prices, the opposite movement is the most difficult bringing in its wake industrial struggles of appalling magnitude.

Nor is it necessary to search tables of wages and to follow the movement of index numbers based on these, for the evidence of the wages adjustment. The general industrial stagnation is the hard fact staring in the face of any honest enquirer. The depression is not confined to the cotton industry but has invaded all forms of industrial activities, even the few industries that had escaped so far being steadily drawn within its ambit.

Though the Bombay mill owner has come into special prominence on account of his vehement agitation, it is an undoubted fact that his difficulties

---

1 Para 192.

are genuine, and that if the cotton industry is to survive, the costs of production must be substantially reduced in accordance with the level of exchange forced upon the country. The Japanese competition and the cotton excise duty have been seized upon as explaining the distress of the industry. But the Japanese competition has been there for the last generation and cannot account for the acute distress which happens to coincide with the sudden rise in exchange. This is established beyond doubt by the fact that the distress has not been alleviated in so far as the abolition of the cotton excise duty might have given a partial relief at any rate. The cotton industry could not in any sense of the word be regarded as an infant industry, and far from needing protection has thriven in the past in spite of the handicap which the jealousy of Manchester placed upon its progress. That such an industry is obliged to seek the help of the Tariff Board is itself a grave symptom suggesting that there was something seriously wrong in the general industrial situation.

That a sudden rise in exchange is a disturbing factor which seriously affects the prosperity of industries will be clear from the enquiries of the Tariff Board. Thus in the Report[1] of November

1 Para 50.

1924, the Board remarked, "It cannot be too distinctly recognised that a continuous rise in exchange must go far to counteract any measures Government may take to encourage industrial development in India, and the more the industry is dependent on the use of indigenous materials the greater the injury which it suffers."

All available evidence is against the vague assumption made in the Report regarding the adjustment of wages and salaries to the new level. The assumption is the more extraordinary in view of the fact that not a single centre reported a *fall* in wages.

While recording the finding that the labour costs in the steel industry had remained unaffected by the higher value of the rupee and that the hope of an early reduction was futile, the Tariff Board states a principle applicable to all industries. "So far as wages and salaries are concerned there has, as yet, been no change in the conditions. The whole-sale prices of the great staple commodities are the first to be affected by a rise or fall in exchange, and the retail prices, on which the cost of living depends, respond much more slowly to the stimulus and do not establish themselves on a new level until some time has passed. An increase or decrease in the wages of labour may follow the change in the cost of living, but only after an interval which is likely to be a long one when circumstances call for a reduction in wages."[1]

To take the instance of agriculture the premier industry of India, the only available evidence from Bombay would indicate that the agricultural wages, far from falling, had a tendency to improvement. The fall in the prices of agricultural produce must seriously affect the prosperity of this industry, reducing the purchasing power in the hands of the agriculturist. Properly examined, this is the cause of the stagnant condition of the piecegoods trade, since the year 1921.

The burden on the key industry of India is substantially enhanced when the agriculturist has to pay the same amount in taxes from his reduced earnings.

But here again the commissioners make an extraordinary assumption that this burden has in fact been materially lightened.[2] Indeed section IV is the weakest part in the Report on account of the exasperating levity of its reasoning.

Against this assumption, it is enough to quote the Finance Member who, after a careful study of the Report of the Taxation Inquiry Committee, thus expressed himself.[3]

---

1 Report, September, 1925 para 27.
2 Para 194.
3 Speech, the Legislative Assembly, 19th August 1926.

"The incidence of taxation per head rose from Rs. 4-2 in 1902-03 to Rs. 5-8 in 1913-14 and to Rs. 11-1 in 1922-23. Distribution between cultivator and non-cultivator on certain hypothetical assumptions was that in 1902-03 the cultivator paid Rs. 2-10 and the non-cultivator Re. 1-8 ; in 1913-14 the cultivator paid Rs. 3-1 and the non-cultivator Rs. 2-5 ; in 1922-23 the cultivator paid Rs. 4-12 and the non-cultivator Rs. 5-5. As the index-number of wholesale prices in Calcutta rose from 100 in 1914 to 180 in 1922, it was doubtful whether the real burden on the cultivator was any higher in 1922-23 than in 1913-14."

The index number, since 1922, would appear to have declined 20 points at least. This fall in prices must considerably worsen the position of the agriculturist, which ordinarily is barely precarious.

In the words of the *Statesman*,[1] "Here, in this land of cultivators, peasant owners and small farms, the lot of the agriculturist is not cast in pleasant places. India has her resources—large tracts of fertile land, well-watered country, and the most patient and laborious peasantry on the face of the earth. But not to put too fine a point upon it, India has a fiendish climate, with all her cultivators

1 24th August 1926.

dependent on the weather. The rain comes too soon, or too late, too much, or too little, or none at all. Flood or famine must ever be feared, and scarcity sits as a bug-bear, year in and year out. Anyone but an Indian would have given up the struggle long ago. But the Indian peasant loves his land, with a love passing that of the ordinary peasant of other countries. Heavily in debt, ill-fed, ill-clad he will cling to the strip of earth that is his be it rock, or sand, or forest, or marsh, with a tenacity that only yields to legal pressure".

Apart from the incidence of taxation, the agriculturist is heavily indebted. Every year new debts are incurred and the artificial appreciation of the monetary unit must add materially to the burden of these debts.

To cite the experience of another country with agricultural interests, Denmark pursued a similar policy of the restriction of currency and credit with the corresponding reaction on its trade and industry. Recently a meeting of 3000 delegates[1] held at Odense came to the conclusion that the principal Danish trade was badly affected by the depression, as a result of which secured as well as unsecured debts had become more of a burden than at the time they were contracted, and from agricultural

1 *The Economist* 24th July 1926.

quarters it was strongly claimed that rates, taxes, and dues shonld be reduced, for instance, by means of a reduction of the number of Government officials and their salaries.

(ii) THE ARTIFICIAL APPRECIATION OF THE RUPEE.

In his budget speech on 1st March 1926, the Finance Member said "After the severe stringency of the winter of 1923-24, conditions in the following season of 1924-25 showed a noticeable improvement and the Bank rate did not rise above 7 per cent. and that only for a period of 4 months—from January to May 1925. It was reduced by the third week in May to 6 per cent. and by the first week in July to 4 per cent. The rate was raised again to 5 per cent. in the fourth week of September and remained there till the first week of December, when it went up to 6 per cent. If, as seems possible, we are able to get through the busy season of this year[1] with a rate not higher than 6 per cent., this will be the first occasion since the establishment of the Imperial Bank of India when the rate has not risen as high as 7 per cent. and if we leave two exceptional war years out of the account when conditions were artificial, it will

---

1 This anticipation was realised.

represent what I think must be a record in the history of Indian banking, and will be an achievement for which the authorities of the Imperial Bank of India will deserve our special thanks and congratulations".

These congratulations, however, have been bestowed in wrong quarters, and strictly speaking the honours of this achievement rest entirely with the Finance Department and its monetary policy.

This policy of the relative contraction of the money supply may be described in the language of the Viceroy's telegram[1] to the Secretary of State, dated the 8th of October 1924, "that the stringency in the market is the direct outcome of Government action in contracting currency, or rather in placing strict limits on possibilities of expansion. ......We should have difficulty in refusing to provide more generously for additions to currency even if we wished to do so and there is serious risk of a financial crisis if we keep the screw on too tight".

The 'tight screw' did not bring about a spectacular crisis but has produced an insidious development the significance of which has not been properly understood by Government and the business community.

Such a restriction of currency ultimately brings

1 Minute of Dissent, para 68.

about an artificial fall in prices, cutting into the profits of industry. Borrowers thus find that they cannot employ money productively and lenders are unwilling to trust them with their 'money'. In consequence, "enterprisers" borrow less, trade languishes and, though the rate of interest falls in consequence of decrease in demand, it does not fall enough to keep the demand from decreasing.[1] Thus while discussing the relation of interest rates to money supply, Kemmerer comments, "As the result of the careful studies of Professor Irving Fisher, we know that a long period of relative contraction of the currency is likely to depress industry through forcing down prices, and thereby to lessen the demand for capital and depress interest rates".[2]

The outstanding feature of the present currency situation is the abnormal abundance, apparently, of the money supply, the immediate cause of which is the stagnation of industrial and commercial

---

1 Professor Fisher quotes President Andrews (*An Honest Dollar* p. 3) to say, "Interest is low......not because money is abundant as before, but because it is not, its scarcity having induced fall of prices and so paralysis in industry". *The Rate of Interest* p. 286. That the appreciation of money does influence the interest rate is now well recognised by distinguished economists. For a complete bibliography on the subject see Fisher, *The Rate of Interest* p. 356, Appendix to Chap. V, Appreciation and Interest.

2 Modern Currency Reforms, p. 68.

activity. It suggests a plethora of floating capital seeking investment, which however industry cannot employ and which it cannot obtain. The degree to which the Government of India Loan was over subscribed comes as a remarkable evidence of the volume of accumulated capital awaiting investment, illustrating also the extent to which industrial investment is discounted.

The first noticeable result of the policy of currency restriction, as soon as it began to be effective was the withdrawal of industrial deposits. A feature of industrial finance in India was the practice of leaving fixed period deposits in industrial concerns.[1] In so far as such deposits were available for industries, it suggested confidence on the part of the public in their stability. No doubt a banker is the proper middleman for receiving such deposits and making these resources available for the benefit of industries. But Indian banking has developed under the influence of bankers trained in the English tradition of banking practice ; and banking and industry in England have not been, so closely associated as in other countries, the divorce of English banking from industries being in marked contrast, for example, to the German banking

1 See the remarks of Sir Basil Blackett in his speech before the Central Bank of India, July 1924.

practice.[2] Indian banks have thus stood aloof from a direct share in the industrial development of the country.

In spite of the appalling general poverty of the masses, thrift is an ingrained Indian habit, and considerable savings, which could be possible only in India, are available in prosperous years. In lean years, which are a constant menace, an immediate recourse to these savings becomes necessary, and custom has made their investment in the most liquid security, namely gold and silver, habitual. According to modern ideas, however, this is equivalent to hoarding, especially as funds locked up in this form might have found useful employment in the industrial development of the country. The future progress of India depends upon a direct access provided to these hoards for banks, and upon banks playing a more prominent part in making these funds available for the use of trade and industry.

Modern ideas of investment had a tendency to grow, until recently, in spite of handicaps. At present these investments take the form of (i) gold and silver (ii) Government Loans (iii) industrial securities.

The policy of the artificial appreciation of the

---

2 Pillai, *Economic Conditions in India*, p. 294.

rupee, has brought industrial investment into serious dis-repute, creating an abnormal demand for the securities of the first two types. This must be regarded as a grave setback to the future industrial development as it depends upon the growth in the habit of *investing in industrial securities*. A habit of investing mainly in Government securities is probably as open to objection as that of investing in gold and silver.

As Mr. Conant has remarked, the stock market is the barometer of the supply of uninvested capital and the demand for it. The fluctuations in prices of different classes of securities on the stock market afford an index to owners of free capital in what direction it can be most profitably employed. "If investments in a given direction are proving unprofitable, they cease to be attractive. New enterprises of a similar character are not inaugurated, because their stocks and bonds cannot be sold..................Through this mechanism of the stock exchange, therefore, is placed in the hands of the public in a large degree the determination of the direction in which new capital shall be applied.[1]

Indications afforded by the prices of industrial securities in the Indian Stock markets are grave,

1 Conant, *Money and Banking*, ii p. 335.

the only securities having a definitely firm market being "gilt-edged" securities. In the accompanying table, the basis for comparison is the year 1921, which has been acknowledged as the year of the worst depression. The quotations are for ordinary shares for the middle of December and thus reflect the investment value of the various securities. Bombay cotton mills are given under a separate head. It may be mentioned that the variation in the average[1] is not accidental, but reflects the actual fluctuation which has occurred in most of the securities quoted.

Table showing variations in the Prices of Industrial Securities :—

Description	1921	1922	1923	1924	1925
99, Tea companies	100	123	181	265	220
49, Jute mills	100	134	123	183	149
88, Coal companies	100	80	63	56	43
23, Engineering and metal works	100	76	52	49	47
7, Flour mills	100	89	70	55	43
4, Oil mills	100	53	39	24	20
5, Saw mills and timber	100	76	50	33	31
12, Cement, lime, Pottery	100	82	62	44	38
7, Sugar, Brewery	100	86	74	77	48
18, Cotton mills outside Bombay	100	82	60	58	55
64, Bombay Cotton mills	100	63	44	38	29
57, Miscellaneous	100	88	69	61	62

1 It is necessary to mention that the average used is arithmetic, though the author does not like it. He would have preferred the

The only two industries which appear to have had a phase of prosperity are jute and tea. Here too, if the conditions are carefully examined,[1] the situation does not justify optimism. The tea industry[2] was assisted by substantial preference in its most important market,and as indications go, it would be none too soon to begin to visualise the recurrence of one of those periodical slumps to which the tea industry appears, inescapably, subject. Indeed in 1925, the possibility of the fall in prices alarmed growers to such an extent that there was a movement to secure a general adoption, if possible, of the policy of a restricted output. But the tea industry in India is not so well organised as the jute manufacturing industry. So limited, indeed, seemed to be the prospects of such a suggestion being carried out, that letters appeared in the press hoping that there would be floods, or rains, or

---

geometric but he does not wish to be drawn into a side controversy about the respective merits of the different averages. In this instance, however, the *tendency* indicated is so general in the case of securities individually that *any* average must bring it out. It may be mentioned that the geometric average might have given lower figures.

1 There would appear to be a further fall in the prices of these securities, especially jute.

2 Under the Imperial preference scheme, Indian tea as Empire produce has the preference of five-sixths of the full rate of 4*d.* per lb.

some kind of partial calamity which would destroy a portion of the crop. An outlook on economics viewing with satisfaction the possibility of the destruction of a commodity, which, in many parts of the world, is considered a necessity, may seem surprising ; but it brings out the essential weakness of the position that the industry cannot afford a fall in prices below a certain level indicating the costs of production which would appear to be not amenable to adjustment to prices as the commisioners[1] have been so ready to assume generally.

The position of the jute manufacturing industry reveals a similar weakness. The organisation of the industry has enabled it to maintain prices artificially by the adoption of a general policy of short time and restricted output. But this cannot go on indefinitely. The world demand for jute is based upon its being the cheapest fibre for bagging agricultural produce. Consumers of jute goods have been finding that they cannot afford to pay the prices demanded though probably they barely cover the costs of production.[2] There would appear to be a gradual growth of bulk-handling reducing the annual demand for jute. If prices

---

1 Para, 192.

2 Dundee would appear, recently, to have carried out a cut of 5 per cent in wages.

are left free, as they will have to be, the industry cannot afford the present costs of production.

The general trend of prices of industrial securities reveals a grave situation if its significance is properly appreciated. It suggests that the depression is not confined to the Bombay cotton industry, but has affected all industries without exception. The gravity of this will be realised if it is noted that the point for comparison was the year 1921.

The policy of the artificial appreciation of the rupee has imposed a serious burden on Indian industries. It is not a rational plan to turn a blind eye to danger signals which presage storms in the industrial life of a country. Nor has the industrial development of India advanced so far, that it can weather these storms unaided.

Assistance in the shape of tariffs and bounties is a strange remedy imposing a fresh burden on the consumer and the tax payer and would provide a singular commentary on a monetary policy justified on account of the relief it is supposed to afford to the Indian finance.

Indeed in getting his 1/6 ratio, Sir Basil Blackett has won a Pyrrhic victory not worth the relief of 3 crores his finance has apparently obtained. The relief is superficial in so far as he does not take account of the fact that his estimated receipts for 1925-26, for instance, from taxes on income worsened by 110 lakhs, indicating the general industrial stagnation. The direct assistance to the Steel Industry in the shape of bounties would come to about 3 crores. The depressed condition of agriculture is reflected by the low purchasing power in the hands of the agriculturist, the loss for this reason on the duty on imported cotton goods amounting to 1.30 crores.[1] Prosperous finance assumes the prosperity of agriculture and industries. A policy which hits this must react upon finance sooner or later.

That an artificial appreciation of the monetary unit should result in a forcing down of the price level is no proof of the domestic adjustments having been completed. The fall of the prices is as artificial as the appreciation, and is simply a reflection of the artificial rise of the rupee. The abnormal condition of the money market and the general industrial and commercial stagnation are an incontestable testimony to a perfect *maladjustment in domestic conditions.*

The Finance Member is applying his patent remedy of contracting the currency supply. In the April crisis, he transferred £8 millions by withdrawing the corresponding amount from circulation.

1 Sir Basil Blackett's budget speech, March 1926.

The abnormal ease in the money market having developed further with its effect on the exchange situation, he recently withdrew £7 million more.

It is hardly necessary to point out that he is applying a remedy which must aggravate the disease.

(iii) THE SIZE OF RESERVES.

In his speech[1] to the Associated Chambers, Sir Basil Blackett said, "It follows that before any attempt is made to stabilise exchange, we must be very sure that we command resources which are necessary to make certain that the attempt will be attended this time by success." It is, therefore, very important to enquire whether the reserves are adequate for maintaining the value of the rupee at the new level recommended.

For the purpose of maintaining the internal and external value of the rupee, the Government of India hold two reserves—the Paper Currency Reserve and the Gold Standard Reserve. While there is no clear line of demarcation between the purposes for which the two rcserves are respectively

1. Dec. 1923. The speech goes on to demonstrate that the reserves available to the Government of India in case of need were adequate for maintaining the value of the rupee at 16 pence ratio.

utilised,[1]—a certain amount of overlapping being unavoidable on account of the interchangeability of the silver rupee and the paper note,—the former so far has mainly aimed at providing for the internal convertibility of the paper-note into the note printed on silver, while the function of the latter has been to maintain the external convertibility of the note printed on silver and incidentally of the paper-note also. The strength of the reserves, however, must be judged as a whole by measuring them against the greatest strain which, in any conceivable circumstances, they could be required to meet.

But are the reserves held by Government of India purely currency reserves, or banking reserves also? In his speech, Sir Basil Blackett proceeds to quote from Keynes, "If the Government's Reserve is held purely to support the currency, then, the maximum volume of rupees and notes, which could, so far as one can anticipate, be spared from circulation and tendered to the Government for exchange, sets an upper limit to the necessary amount of this Reserve. If, on the other hand, it is intended to act as a banking reserve and to ensure India's ability to meet her international

1 This must be evident from the recent manipulation of the currency reserve to support exchange.

obligations at all times, then its upper limit is set by the probable maximum amount of the adverse balance which could arise against India for immediate payment."

The conclusion, Sir Basil Balckett arrives at, is quite sound, the reserves of international currency held by the Government of India are "banking reserves as well as currency reserves, that is, they are intended to be a guarantee of solvency in the face of any conceivable balance of indebtedness against us, even if at the same time we had to face an internal banking crisis as well."

This, however, does not give a complete account of the contingencies in which the reserves may be required. India has, besides, to meet every year sterling expenditure in England, which would be 'some £35 millions, a large sum in proportion to the total foreign remittance business of the country'.[1] Ordinarily this is met from the surplus of India's trade balance. When therefore, this becomes unfavourable, the whole of this charge must be borne by the reserves.

In the event of a single unfavourable trade balance, therefore, the Gold Standard Reserve would be practically wiped out by the sterling expenditure alone, the Paper Currency Reserve

1 The Report, para 103.

would have enough work in meeting an internal banking crisis, and what little, if any, is left from the two, would have to make good 'the guarantee of solvency' by meeting the balance of indebtedness to the fullest extent. If the crisis is prolonged for another year, it does not require much imagination to visualise the situation.

It will be five years before the scheme formulated by the commission can be given effect to in all its details. A successful inauguration of the scheme depends upon the existing reserves remaining unimpaired in strength. Indeed in the transitory period, the Government of India is expected 'to pursue a policy calculated to strengthen the position of the Bank in relation to gold when it assumes charge of the currency and the Reserve.'[1]

---

1 Para 166. This will be clear if it is noted that a statutory obligation will be imposed upon the Bank to maintain a minimum percentage of 40 per cent in the form of gold and gold securities. Thus in para 78, "We propose that it should laid down that gold and gold securities should form not less than 40 per cent of the Reserve. In view of the nature and extent of the obligations with regard to the provision of gold which we propose should be placed upon the currency authority, that authority should strive to work to a reserve ratio of from 50 to 60 per cent. In the event of the proposed gold savings certificates proving a popular form of investment, the possible demands for gold by Government for payment of these certificates on maturity would no doubt necessitate a further strengthening of the gold holding in the Reserve, but to what extent experience alone can show. The holding of gold, which now

Practical considerations would, therefore, suggest that the policy suitable for the transitory period is one which would promote the strengthening of the reserves. Five years mean a long period and it will be irrational to assume that all these years will be prosperous. Recent experience has demonstrated that a threat to the present high level of exchange may develop even in ordinary years. It will be a singular irony if the whole scheme falls through in carrying out the 'least of the recommendations' of the commission.

Government, therefore, should not be in a hurry to assume a legislative responsibility which might wreck completely the chances of a successful inauguration of the principal scheme. Practical financiers cannot afford to be pedants. Caution becomes the more necessary on account of the previous history of the rupee which will not brook artificial interference. India can ill afford another weakening of her reserves in an unsuccessful attempt to maintain a mere level of exchange.

---

stands at about 12.8 per cent. should be raised to 20 per cent, as soon as possible, and in any case in not more than 5 years, and to 25 per cent in 10 years, with a minimum of Rs. 30 crores from the outset. This would give a minimum of about Rs. 60 crores after 10 years on the basis of the present circulation. During this period no favourable opportunity of fortifying the gold holding in the Reserve should be allowed to escape."

Apart from a failure of monsoon, there is another direction from which a threat to the present level of exchange would appear to be likely from present indications, though the possibilities of a further development cannot be forecast with certainty.

The weakest point in the Indian currency situation till the rupee occupies its predominant place, is its abnormal sensitiveness to the silver market. The present weakness in exchange, if carefully examined, will be found mainly to be related to the crisis in the silver market which would appear to be developing.[1] There is a limit to the premium which the rupee as a silver coin can command above its silver contents. A fall in silver must exercise a downward pull on the value of the rupee. The threat is the more serious if the value to be maintained is too high.

The policy, during the transitory period, therefore, should be definitely other than the

---

1 At the time of writing, silver had fallen as low as 26d. The past history has shown that a crisis in the silver market reacts upon the level of exchange. For an analysis of the complex bullion operations this sets up, see *the Rupee and the Gold standard* pp. 19-23. It will be a curious situation, if, in the contingency developing, the attempt to maintain the 1/6 ratio results in the utilisation of the gold and sterling resources of India for financing the purchases of silver, the most useless metal for the future requirements of the Indian monetary system.

mere maintenance of the 1/6 level. Indeed this is the least part of any rational plan for the main currency reform. Five years provide an excellent period, which, if properly utilised, might enable India to consider the possibility of putting into effect Sir Basil Blackett's scheme which has the merit of eliminating the threat to the currency from fluctuations in the price of silver.

II. THE GOLD BULLION STANDARD.

To come to the principal recommendation of the report, it must be conceded without hesitation that it makes an epoch in the Indian currency history. The Herschell Committee marked the definite end of the monometallic silver standard in India, and since then the country had been endeavouring to pass over the chasm which divides a silver from a gold standard. For the first time, however, it is now recognised that a true gold standard postulates that gold and not the silver rupee must be the standard of value and the basis for legal tender in currency. The statutory obligation, to be imposed on the currency authority, to buy and sell gold without limit at a prescribed parity, establishes the principle that 'gold must be the standard of Indian currency at a fixed ratio, and that the currency authority admits it and must maintain it.' [1]

While, thus, fully recognising the advance this means upon the previous position, the particular measures suggested must be submitted to a rigorous scrutiny in order to find out whether they will achieve the object which the commissioners have in view. Caution is imperative in view of what followed the well meaning proposals of the Fowler Commission.

The proposal that an obligation should be imposed by statute upon the currency authority to buy and sell gold in quantities of not less than 400 fine ounces suggests that the commissioners have been influenced by the analogy of the English example.

While it is not wrong to follow such an example, we have to recognise the practical difficulties that may arise in India on account of the peculiar position occupied by the silver rupee and the paper note in the Indian currency system.

In England, there never was a complication of a silver coin in circulation holding a constant threat to the normal functioning of the gold standard. While silver coins occupied a subsidiary place in circulation, the standard coin before the

1 Para 61.

war was gold into which the paper note was directly convertible. The standard of the paper note was, thus, gold itself.

On account of the war, the convertibility of the paper note into gold came to an end in England as in many other countries. The gold standard, therefore, ceased to function, and the standard of circulation became the depreciated paper note itself.

With improvement in general conditions, the gold parity was re established in April 1925. With the restoration of the convertibility of the paper note, gold automatically becomes again the standard of value.

In India, however, the paper note holds a different position. The paper note is convertible into the rupee. The standard of the paper note is, therefore, the inconvertible note printed on silver.

The termination of the anomalous provision by which one form of note, the paper note, is convertible by law into another form, the silver note, is rightly regarded by the commissioners an essential step in any scheme for the Indian currency reform.[1]

Had gold been the *direct* standard of both these forms of notes, the termination of this convertibility of one note into another would have been a simple proposition.

---

1 Para 69.

But, in India, the standard of the paper note has always been the silver note.

The commissioners propose that new notes should be *legally* inconvertible into silver rupees though *practical* facilities for such conversion into rupees should be continued. At the same time, there is a suggestion that the coinage of rupees should be stopped.

But in the sphere of currency, practice nullifies the law. If convertibility of the new notes into silver rupees is made customary, for practical purposes, the standard of the new notes will continue to be the rupee.

We, thus, have to face seriously the situation that side by side there will be two forms of paper notes, one,—the present issue, which according to the commissioners must be redeemed by rupees,- legally convertible into silver rupees, and another, the new issue, legally inconvertible but practically convertible into the silver rupees.

The stock of silver rupees with the currency authority will, therefore, have to meet in practice the demand for convertibility of *both* these forms of paper notes. Probably for some time the existing stock of rupees would be adequate.

The testing time, however, must come sooner or later when such convertibility will cease to be practicable. Immediately this situation arises, a crisis similar to that of the year 1900 may be regarded as a certainty.

If the currency authority asserts the *legal* inconvertibility of the new notes, they will be unacceptable as compared with the other notes. The provision for the expansion of currency will, immediately, cease to function and the rupee must leave the upper gold point.

If, on the other hand, the currency authority weakly decides to get new rupees coined as the Indian Government did in 1900, the entire scheme of a gold standard will fall to the ground and the note printed on silver will continue to be a menace to the stability of the currency system.

It is this circulation of the costly notes printed on silver which is the main obstacle to further advance.

Sir Basil Blackett's scheme is ambitious and formulates measures to retire a considerable number of these, thus reducing the rupee definitely to a subsidiary position and eliminating permanently the threat to the currency from fluctuations in the price of silver.

The scheme was rejected by the commissioners on the ground among others that it may not be possible to secure British and American cooperation in the matter of raising credits for the carrying through of the plan.

Failing outside assistance, however, India can act alone and stop entirely the further coinage of rupees. France did this in 1873 in the case of the silver franc whose unlimited legal tender status was not an obstacle to the transition to an effective gold standard. If France could achieve this at a time when she had to find a big indemnity to pay Germany, India is obviously in a very strong position.

The stoppage of the further coinage of these notes printed on silver is the starting point of any currency reform that may be formulated, Whatever scheme may be further recommended must fit in with this essential measure. The commissioners obviously accept this position.

The future expansion of currency must therefore occur in a form *other than* the note printed on silver, or a paper note based upon such silver note.

The commissioners take the view that in regard to the present note issue, so long as they remain in circulation, the Government's promise to redeem them in rupees must be religiously kept.[1] When the Reserve Bank is in a position to issue its own

1 Para 69.

notes in substitution for the Government notes now in circulation, the commissioners further recommend that not later than five years from the date of the charter becoming operative, the Government notes still outstanding shall cease to be legal tender except at Government treasuries.[1]

The new note issue, however, that is to take the place of the existing note circulation, can do so only if its metallic backing in terms of the convertibility into gold is as tangible and visible as the metallic backing of the existing issue in terms of the convertibility into silver rupees. This is the simple logical issue that has to be faced, if the scheme is to have any chance of success.

Indeed the commissioners appear to have felt vaguely that their scheme may only have 'an indirect effect upon the people at large in establishing confidence in the currency',[2] and they cast about to find some further and more direct and visible means for bringing it home to the masses that 'gold is the standard of value of the rupee and that the one is convertible into the other'. They, therefore, recommend that savings certificates, redeemable in gold or legal tender money at the

1 Para 141.

2 Para 67.

option of the holder, might be issued in denominations of one tola and integral number of tolas giving the holder an attractive yield in interest.

Unless the postal officials or other Government servants who are charged with the duty of dealing in these certificates are to turn into goldsmiths weighing out the gold by scales, the use of a coin cannot be avoided, however much the commissioners may dislike it. A coin is the most convenient form in which an unmistakeable guarantee of particular weight and fineness can be embodied.

Common sense would suggest that if coins are issued in this manner, it would be advisable to make them legal tender. It is preferable that a coin should be circulated rather than melted or hoarded.

But to come to the main difficulty that must arise from the recommendation of the commissioners, the new note issue in the hands of the ordinary holder will *not* have the conspicuously visible backing in terms of gold *vis-a-vis* the Reserve Bank, while he has the tangible idea that through the medium of savings certificates the Government would redeem them. A situation, therefore, is not unlikely that while the Reserve Bank would be issuing notes, the duty of redeeming them may, in an important measure, be imposed upon the Government.

Objectionable as this would be in view of the accepted principle that the control of currency and credit must be unified in the hands of a single authority, the fundamental problem, that must be faced, is that the new note issue will, in the first instance, have to circulate side by side with the present issue and must ultimately replace it. This can be successfully achieved *only* if their gold backing is as tangible and visible as the silver backing of the present issue.[1]

A system of convertibility in terms of gold *comparable to the present* is, therefore, an indispensable condition for the success of the new note issue.

A coin is thus as necessary to establish this direct convertibility indespensable for the success of the new note issue as for their indirect redemption through the medium of savings certificates.

The commissioners however have expressed their desire that gold shall not as far as possible be used as currency. This purpose, however, could be achieved by making the coin large enough so that it could not be ordinarily employed in settlement of transactions while it would ensure the convertibility adequately by making it at the same time

1 That the commissioners have not realised the importance of this will be clear from their recommendation, for instance about the new one rupee notes.

real and conspicuous. A coin containing the gold equivalent of Rs. 50 would just meet this object.[1] Another safeguard also can be introduced by arranging the buying and selling rates of gold bullion in such a manner that it would be to the interest of the holder of gold bullion to sell it for paper to the Bank rather than carry it to the mint to be coined.

An important objection urged against Sir Basil Blackett's scheme was that India would require outside assistance to carry it through. It seeks to impose a legal tender limit upon the silver rupee and this could not be done unless there was a readiness to redeem silver rupees offered for conversion.

This, however, only means that as such redemption cannot be arranged, the rupee must remain unlimited legal tender. But in order that the threat inherent in the excessive stock of silver coins in an avowedly gold standard scheme may be eliminated in the course of time, the coinage of silver rupees must stop entirely. It follows as a logical consequence that the future expansion of currency shall *not* be based upon the note printed on silver.

Once the position is accepted that the silver rupee must remain unlimited legal tender, the

1 *The Rupee and the Gold Standard* p. 89.

question of making an extra demand upon the gold supply of foreign nations does not arise.

In the past, the expansion of currency[1] occurred against the ordinary favourable balance of trade after the annual sterling expenditure in England was provided for. A considerable quantity of gold was received directly by the Secretary of State against the sale of council bills offered in order to satisfy the demands of trade beyond his own requirements; while from the other gold which actually reached the shores of India, a considerable amount was presented to currency offices in India for obtaining currency.

	Excess of Exports over Imports on Private Account,	Sales of Council Bills in excess of budget estimates	Net receipts of gold presented at currency offices.
	£.	£.	£.
1909-10	47,213,000	10,896,586	6,344,000
10-11	53,685,300	11,283,303	280,000
11-12	59,512,900	9,900,250	9,305,000
12-13	57,020,900	10,259,706	4,134,000

The assumption made in regard to Sir Basil Blackett's scheme that India would require large credits apart from the ordinary imports of gold for private use is not correct. If during the last three or four years a large amount of gold was utilised

1 See also the letter of the Bengal Chamber of Commerce of July 1924, quoted in *the Rupee and the Gold Standard* p. 18.

for private purposes this was because the maintenance of the 'ineffective and fictitious' 2/- ratio on the statute book rendered its use for obtaining the much needed currency impossible. With the decision however, not to impose a legal tender limit on the rupee, the necessity of such additional credits disappears.

Gold that India normally receives is the balance of payment from other nations, gold being the recognised means of settling international debts. She can thus import no more than her excess of credits over debits in her dealings with other countries. From this excess, India has first to meet her sterling expenditure in England. So far as England is concerned, *apart from* this annual sterling expenditure, India imports more than what she exports, besides utilising the services of the English shipping and insurance companies; the balance of indebtedness in her dealings with England is ordinarily against her. Gold, drawn by India, is therefore what other foreign countries owe her.[1]

The crux of the problem therefore is that the future expansion of currency against these imports of gold shall dispense altogether with the silver note as a base. But the growth of such paper issue

1 Para 45, The Minority Report, Smith Committee.

depends upon conditions of a practical convertibility into gold intelligible in comparison with the present convertibility into silver rupees. Any artificial restrictions upon such convertibility will react upon the popularity of the new issue and defeat the main purpose with which the scheme has been framed.

A convertibility that is intelligible only to bankers and brokers would have scarcely any significance for the general public.

An important objective in framing any gold standard scheme is to attack the hoarding habit and to make the stores of gold at present lying idle available for productive use.

The Indian hoarding habit is more or less a crude form of investment habit, the purpose of which is to lay by savings in a liquid security which should be available in times of want following the precarious prosperity of good years. A bank note for which gold may be obtained on demand by the holder is the only practical medium to introduce a more economic form of saving in place of the present wasteful practice.

It is exactly in this essential that the scheme must fail entirely. The habit of investment is already there in the Indian people. Apart from the complications which may develop in practice, gold savings certificates may foster the tendency to investment in Government securities. This however does not constitute a desirable advance upon the habit of investment in gold and silver. What is required is that banks shall have a direct access to these idle hoards of gold which would thus, be available for the benefit of trade and industry; what is wanted is that the *banking habit* shall be fostered. For this a bank note 'as good as gold' is an indispensable preliminary.

Nor is the complicated system of the buying and selling rates of gold proposed by the commissioners conducive to the effective functioning of the scheme even according to the principles set before themselves in framing it.

Thus while recognising that a sound gold standard postulates a statutory obligation upon the currency authority to buy and sell gold at a price equivalent to the par value of the currency, it is urged that the operation of the currency authority should be normally confined to gold movements for purely monetary purposes, leaving the wholesale bullion market free in its ordinary dealings. It is, therefore, proposed that (i) when exchange is at the upper gold point, the selling price for delivery at Bombay, Calcutta or Madras should be the par value of Rs. 21. as. 3 ps. 10 per tola of fine gold; (ii) when exchange is below the upper gold point, the selling price for delivery—according to the calculations given in Schedule I—at the option of the holder, in London at the rate of Rs. 21. 7 as. 9 ps., and in Bombay at the rate of Rs. 21, 11 as. 9 ps. (iii) the buying rate would be Rs. 21. 3 as. 10 ps.

As contemplated by the commission, the Bank would appear in the market as a purchaser of gold bullion at the fixed price of Rs. 21. 3 as. 10 ps. to an unlimited extent. The normal consequence of this would be that the price of bullion in the indigenous market must be slightly higher than this. With an ordinarily favourable balance of trade, the rate of exchange would be a little higher than the par rate, with a tendency to move towards the upper gold point. Thus in his ordinary operations, there is a constant threat to the bullionist that the Reserve Bank might intervene with sales at the par rate, and the uncertainty might drive him from the field altogether.

On the other hand, the Bank's offer, when exchange is below the upper gold point, to sell gold for delivery in London at Rs. 21. 7 as. 9 ps. and in Bombay at Rs. 21, 11 as. 9 ps., favours deliberately London as the place where gold would be ordinarily laid down. This is merely perpetuating the evil of the gold exchange system.

The system recommended, therefore, is neither simple nor certain, and unless the full implications of the proposals are carefully explored, the actual results may be just the opposite of what commissioners themselves contemplated.

A convertibility which assumes three different rates of conversion in different circumstances is a very uncertain convertibility. A convertibility besides which is of practical significance to bullionists and bankers only and which favours London deliberately in ordinary circumstances as the place where gold would be laid down, does not suggest 'a convertibility that is intelligible to the uninstructed, with a backing that is tangible and visible.' Such a standard lacks 'the characteristics',—claimed by the commissioners for their plan,—'necessary to inspire confidence in the Indian people, to promote the habits of banking and investment, and to discourage the habit of hoarding precious metals.'[1]

A par of a currency is the rate at which the currency can be converted into gold bullion. When there is a standard gold coin, its gold contents fixed by law usually give this par. In the absence of a gold coin, however, the rate at which the currency authority is prepared definitely to

1. Para 61.

redeem the currency fixes the par. If this is indefinite, the par also becomes indefinite.[1]

A definite rate of redemption is, therefore, the starting point of any scheme for a true gold standard. This again *must* be the proposed par rate if the 'par' is to have any practical significance. Thus the gold standard in England may be said to have been restored only in so far as the Bank of England as the currency authority is prepared to redeem sterling at the sterling parity.

It is possible to devise a modified scheme, at once simple and certain, which will achieve the object of the commissioners,—that 'the currency of the country must be linked with gold in a manner that is real and conspicuously visible,' and yet as far as possible 'gold should not circulate as money',—and which will obviate the difficulties that must arise from their proposals which are not only complicated but unsound in some of the assumptions on which they proceed. For this purpose, reference may be made to the principle on which Ricardo's plan is constructed.

---

1 This is why the calculations of the commissioners in Schedule 1 based upon the assumed par of Rs. 21. 3 as. 10 ps. are unsound. 'p' can be Rs. 21. as. 3. ps. 10, only if there is an unmistakable obligation undertaken by the currency authority to redeem currency at that rate. As the rates are calculated, it is not unlikely that they would prove to be unreal and may not fit in with the actual gold movements.

By this, an incentive is offered to holders of gold bullion to convert it into paper rather than coin, while the Mint may remain open as a safeguard against an artificial interference with the quantity of circulation. In the case of India, the Mint would be, besides, of invaluable assistance in establishing confidence of the uninstructed in the stability of the new system.

The following scheme[1] may therefore be recommended. (i) The Bank's selling rate should be the par value of Rs. 21 as. 3 ps. 10 per tola of fine gold ; (ii) the Bank's buying rate for gold bullion should be Rs. 21 per tola of fine gold.

As silver rupees will remain unlimited legal tender and would be freely accepted in payment of public dues, there will be no greater incentive to convert under the new system than there is now. As proposed by the commissioners, the buying and selling rates may be enforced upon the currency authority ordinarily with reference to quantities of not less than 400 fine ounces, no

1 The figures are illustrative only and may be modified to suit any other parity. If the seignorage is fixed at one per cent of the value, the holder of gold bullion, in converting it into coin, would have to bear this charge and a further loss in the shape of interest say, at the rate of 5 per cent. per annum for a month, apart from other charges such as melting and refining. Taking the parity of the rupee as Rs. 21 as. 3 ps. 10 per tola, the loss of the holder of bullion in converting it into coin would be as. 4 ps. 10 *at least*.

limitation, however, being imposed as to the purpose for which gold is required. This incidentally means a definite acceptance by the currency authority of the ultimate gold basis of the silver rupee.

To ensure, however, the success of the *new* note issue, a system of convertibility into gold comparable to the present is necessary, the new notes, therefore, should be freely convertible into gold, the lowest gold coin thus issued being the gold equivalent of Rs. 50.

To emphasize the change in the legal status of the rupee the ratio at which it should circulate as coin must be embodied in Sec. 12. of the Indian Coinage Act, which makes the rupee a legal tender.[1] A provision should be introduced in the Coinage Act for the coinage of a 50-R. gold piece. Mints should be open for the coinage of these pieces.

Coinage of silver rupees must stop entirely. Special care should be taken *not* to impose a statutory obligation upon either the currency authority or Government to supply new rupees. In future the supply of rupees must take place on a level with the supply of other token coins.

---

1 For the detailed argument, see *the Rupee and the Gold Standard* Chapter II, Sec. I.

III—A CENTRAL BANK FOR INDIA.

When the commissioners proceed to deal with the question of the authority who should control the working of the currency and credit machine, they outline a proposal which is of far reaching importance and requires careful study before legislation of any sort is undertaken.

At the meetings of the Calcutta and Madras shareholders of the Imperial Bank held recently, the Chairmen of the Local Boards wisely refrained, at this early stage, from expressing any opinion, preferring to await a full exposition of the views of the Government and the Legislature. Sir Basil Blackett, when introducing the currency bill, also appeared to take the view that the major proposals regarding the reserve bank and the gold bullion standard would require 'intensive study by the Government and people before final conclusions are formulated'.[1]

Bombay would appear to be hostile to the proposal mainly on the ground that it would react

1 The Finance Member has since come forward as a champion for a Reserve Bank on the lines recommended by the Commission. See his correspondance with a Bombay bullion merchant—*Capital* 16th Nov. 1926. Sir Basil Blackett would do well to exercise some restraint in making pronouncements in advance of considered commercial opinion on important questions.

on the prestige of the Imperial Bank. Calcutta would appear to be indifferent, it being even suggested in some quarters that as four Governors of the Bank have been signatories to the Report, they must have satisfied themselves that the proposal was not against the interests of the Bank.

To the general public the proposal comes somewhat as a surprise. The questionnaire of the Commission did not contain a hint as to the possibility of their considering the establishment of a new institution. Indeed it was framed apparently with the object, among others, of ascertaining from witnesses the general terms on which the control of currency may be transferred to the Imperial Bank, a proposal on the lines recommended not being even formulated till the commission reached London. Sir Henry Strakosch, it is stated, in the meanwhile framed a scheme which the commissioners were ultimately persuaded to accept probably not without adequate consideration.[1]

The details of the scheme, however, must be subjected to a rigorous scrutiny ; and it would be well to refer it to the Commission or Committee which must be appointed to enquire into the banking development of India. It may well be claimed that at present sufficient data even are not

1 The *Capital* ; the Money Market Review, 9th Sept. 1926.

available to enable a satisfactory conclusion to be reached on the important issues raised.

That India needs a strong central institution having the note issuing function for her banking progress will not be challenged in any quarter.

So convinced were the Chamberlain Commission of the importance of this question, that they urged Government 'to hold an enquiry into it without delay, and to appoint for this purpose a small expert body, representative both of official and non-official experience, with directions to study the whole question in India in consultation with the persons and bodies primarily interested, such as the Presidency Banks and either to pronounce definitely against the desirability of the establishment of a State or a Central Bank in India at the present time, or to submit to the authorities a concrete scheme for the establishment of such a bank fully worked out in all its details and capable of immediate application.[1]' At the same time they published as an annexe to their Report, a scheme prepared by Mr. J. M. Keynes by their direction in collaboration with Sir Ernest Cable. They had before them another scheme framed by Sir Lionel Abrahams, but hesitated to pronounce upon either of them as they thought they had not enough time

1 The Chamberlain Report, para 222.

to submit them to a searching examination and as the witnesses whom they had examined had not been in a position to consider or pronounce upon the specific proposals therein contained.[1]

The war, however, supervened ; and the recommendations of the Chamberlain Commission remained in abeyance. Subsequently the entire currency policy went into the melting pot. The need for some banking reform, however, was regarded so urgent that the Imperial Bank Act, admittedly a half-measure, amalgamating the business of the three Presidency Banks, was passed and received the assent of the Governor General on the 19th September 1920 about the time Government retired from the exchange market after the disastrous reverse sales.

In the circumstances under which the Imperial Bank came into existence, the uncertainty with which the currency policy was surrounded, would have made it impossible even to induce the Bank to take over the control of the paper currency. In spite, however, of the serious handicap of having no right of note issue, the Bank has performed with efficiency a number of important functions belonging to a Central Bank. It has acted as the Banker for the Government of India, being

1 The Chamberlain Report, para 221.

entrusted with the balances, and has assisted Government in the management and issue of public loans. It has given the country the benefit of a consistent bank rate policy. It has been holding deposits of other banks and assisting them with advances when necessary. It has intervened vigorously as in the case of the failure of the Alliance Bank of Simla, to prevent general panic. Naturally there are important restrictions upon the type of banking which may be undertaken by the Imperial Bank, introduced with the obvious intention of keeping the dealings of a semi State institution on the soundest possible lines. The general expectation was that as soon as a definite monetary policy was formulated, the Imperial Bank charged with the note-issuing function would be the strong central institution so necessary for the banking development in India.

The commissioners have, however, come forward with a proposal for a new Central Bank, taking the view that whatever the advantages, the disadvantages of utilising the existing machinery of the Imperial Bank for the purpose out weigh them, though they have not fully developed the reasons that inclined them to this view. The public, however, had no such scheme before them, nor was the sort of a whirl-wind tour in which the commissioners were engaged, calculated to elicit a considered criticism of an important proposal of the type formulated.

The public, therefore, have before them two rival schemes, a cursory glance at Mr. Keynes' proposal being sufficient to convince anybody of its very high merit. The decisive consideration should be the immediate applicability to Indian conditions and practical benefits to India, all other considerations academic or sentimental being subordinated to this.

The fundamental point to be borne in mind is that the system devised must function for a country which is practically a continent; and while it ensures a firm policy in the general control of currency and credit, it must take account of variations in local conditions and must establish a direct contact with the internal banking system, including the indigenous, to enable it to enforce its general policy.

In outlining their scheme, the commissioners would appear to have been influenced by the example of the American system, and also the South African system which has borrowed some features from America. The proposals, however, appear to proceed upon an inexact study of the conditions under which the Federal Reserve

System came into existence, nor, does their applicability to India appear to have received the close investigation necessary for ensuring the successful functioning of the system devised.

In order to appreciate the special features of the American system, a brief review[1] of the stages by which it developed will be useful.

The phenomenon in American banking from its earliest history, which must attract the attention of a student of the banking systems of the world, is the very great multiplicity of independent banks. In 1863, the number of banks authorised under the laws of the various states of the United States was 1466, with the capital of $405 millions and deposits $394 millions. All these had their own circulation, falling under four general types, the issues being based upon general assets, or public securities, or the faith and credit of the states, or protected by a general safety fund. It is not surprising, however, that the conglomerate currency they created should have left unsavoury memories behind it. Senator Sherman in a speech in the Senate in February 1863, quoted from an article in the 'London Times' the following estimate of the condition of the American

1 For more details the reader is referred to standard books on the subject.

currency ; "by the want of a paper currency that would be taken in every state of the Union at its nominal value the Americans have suffered severely. The different states were as to their banking notes so many foreign nations each refusing the paper of the other, except at continually varying rates of discount. Frequently there was a greater loss on paper taken or sent from an eastern to a western state than on English bank notes converted into Austrian money in Vienna. Only adepts and regular money changers could tell whether a note was current or not, the paper of broken or suspended banks remaining in circulation long after their value had departed. The Federal Government avoided loss by refusing all paper money of every kind. Its import duties were taken only in gold, and internal revenue it had none. The first appearance of a department for collecting that kind of taxation is in the present bill proposed by Mr. Chase. But the difficulties of the Government have compelled it to issue a paper that will pass current in every part of the territory. Through the evils of the war the people will at least gain that deliverance from the previous confusion of their currency which to Europeans appears a barbarism. If the social storm sweeps away the 'wild cat' and bogus banks of the union, it will have left some small compensation for the wreck of better things."[1]

The State banks of this period would appear to have left unhappy memories in America. The several systems, taken in the aggregate for the entire country, had the great practical defect of lack of uniformity. The defect, however, was great enough to obscure the essential merits of many of the state systems and to make any system which was national in its scope and uniform in its character attractive to the business community.

The national banking system which was set up at this stage, had its origin in the management of the finances during the civil war. As a system, it garnered up the lessons of many experiments with banking upon securities, adopted some of the good and discarded most of the bad features and afforded the country two of the great benefits of a sound currency—security and uniformity.

The National Bank Act of 1864, authorised the creation of National Banks subject to conditions as regards the minimum capital and its relation to the population of the place where they were organised. Of the capital, not less then one-third was to be invested in Government bonds.

1 National Monetary Commission, *The Origin of the National Banking System* p. 15.

The comptroller of currency was authorised to issue notes of a standard type to the banks to the amount of ninety per cent. of the face value of the bonds. A tax was placed on the issues of the state banks, with the result that those independent institutions either relinquished their issues or joined the national system with a considerable gain to the country in stability of its financial system. Banks were required to keep in 'lawful money' a reserve equal to a certain percentage of their aggregate notes in circulation and deposits. The comptroller of currency was further authorised to appoint suitable persons to make examinations of the affairs of the banks once a year. The examinations were made gradually severer as defects were disclosed and increased to two in a year. This system of Government examinations for the assurance of the soundness of the banks became one of the most important and characteristic features of American banking.

The system, thus outlined remained in force for half a century ; subsequent legislative modifications related to details only and did not affect the fundamental principles underlying the system. From this period, American banking underwent a great expansion in keeping with the geographical and commercial development of the country. In 1913, banks operating under the Act numbered 7514, with the capital of $1068 millions and the circulation of $758 millions.[1]

Three chief characteristics in the national banking system stand out with marked distinctness, the facility with which new institutions could be incorporated, the lack or prohibition of branches, and note issue based upon Government paper as security.

The growth of a highly individualised system of banking, in these circumstances, was to be expected. This is in marked contrast to the centralised systems of Europe. The system fostered the growth of a large number of independent banks and the capital and reserve requirements together with the system of periodical examinations provided probably an adequate safeguard against unsound banking in normal times.

In periods of crisis, however, the system failed completely. In the first place, a system of note issue which rests upon evidences of public debt as security was without elasticity in the sense of responsiveness to the demands of trade and its volume fluctuated with the price of 'gilt-edged' securities. In the second place it was discovered

1 Conant, History of Modern Banks of Issue. p 435.

that reserves, though obligatory upon the banks, being decentralised, could not meet the sudden strain developing in a crisis upon the unassisted resources of the individual banks.

In the nineteenth century, however, the question of banking reform was overshadowed by the controversy about the currency standard which the powerful silver interests of America kept in the front. It required the crisis of 1907 to furnish the necessary warning as well as impetus for the undertaking of a thorough reform in a spirit different from that which so for had characterised the American attitude towards the banking question.

The necessity for providing some safeguard against bank suspensions was considered so urgent that the 'Aldrich-Vreeland' bill was quickly passed in 1908, avowedly temporary in character by the provision that it should continue in force only until June 30, 1914. The new law, however, contained a provision for the appointment of a National Monetary Commission to report "what changes are necessary or desirable in the monetary system of the United States." This body made a thorough examination of foreign banking systems, subcommittees held conferences with leading bankers at the financial centres of

Europe, and monographs were prepared for the commission by economists and specialists on the banking systems of nearly every commercial country.

The actual progress in the American opinion involved two elements ; an admission that purely emergency organisation for "relief" would not meet the requirements of banking reconstruction and a recognition that mere transplanting of foreign banking systems to American soil without adaptation to local needs and peculiarities could never succeed.

It was recognised at an early stage that a Central Bank of the European pattern had very little chance of success in the special conditions of the American banking development. The extremely 'individualistic' bankers of America could not have tolerated the setting up of a powerful independent institution, enjoying the special patronage of the state and having the control of the entire currency and credit policy in the framing of which they bad no voice. Thus Professor Scott said in his statement to Representative Carter Glass, who was primarily responsible for the framing and carrying through of the Federal Reserve Act, "A central bank can be most efficient when it is free to do business with the general public as well as banking institutions. Indeed it is only when it has this power that it can efficiently regulate the market rate of discount and control the international movement of the precious metals. I believe that a central bank with such powers would be best for the United States, but I fear that the establishment of such an institution would be opposed by banks and banking interests on the ground that they would suffer from the competition of such an institution. Competition of a certain kind and a certain degree would result from the establishment of such an institution, but such competition would be regulative and not repressive or destructive in its influence, and the resulting benefits to banks would in my judgment greatly outweigh any slight losses here and there and now and then experienced. However, I doubt if the bankers of this country could be convinced that this view of the matter is correct, and I, therefore fear that an attempt to establish such an institution would fail."

The monetary commission submitted its report in January 1912. While the report was not destined to be formally taken up by Congress, a new turn was given to the discussion of currency legislation in the United States by the choice in the elections of 1912 of a Democratic President and a

Congress Democratic in both branches. Upon the meeting of the short session of the 62nd Congress, consideration of monetary legislation was begun by a Sub-committee of the House Committee on Banking, headed by Carter Glass. The voluminous report of the monetary commission was referred to this sub-committee and a careful survey was made of all available material and other pending proposals which included the plans proposed by Fowler and Muhleman.

The underlying idea in all these proposals, however, 'was the concept of co-operative organisation of existing banks for the purpose of providing a jointly guaranteed or secured type of credit representative which could be used as reserve funds. The idea was logical, because of the fact that it rested upon the evolutionary institution which had been developed in American financial life as a result of necessity'.[1]

This basic idea was incorporated in the new measure destined to be the Federal Reserve Act. The report of the Banking Committee thus laid down the general principles underlying the measure :—(1) The idea of centralisation or cooperation or combined use of banking resources, is the basic idea at the root of central banking argument

1 Willis, *The Federal Reserve System* p. 48.

(2) It is not necessary in order to obtain the benefits of the application of this idea that there should be one single central bank whose activities should be coterminous with the limits of a nation's territory ; (3) Equally good results can be obtained by the federating of existing banks and banking institutions in groups sufficiently large to afford the strength or co-operative power which is the chief advantage of the centralisation.

What is noteworthy is that it was opposition to the 'central bank' idea which was responsible for the present structure of the federal reserve system. The proposed reserve banks, it was decided, must be co-operative institutions rendering service for the good of all the banks *that are stock-holders in them*, securing a fair 'return' on the holding of their stock, while the Government must get the excess profits of the institutions.

The Federal Reserve Act was designed to meet the two serious defects of the National Banking System :—the lack of concentration of the 'reserves' of the banks, and the lack of elasticity of the note-issue and the absence of facilities for rediscount in times of pressure in the absence of a strong central institution like the European banks of issue.

It was therefore provided that the 'legal reserves' of the member banks should consist of deposits in a Federal Reserve Bank. The other difficulty about the inelasticity of note issue was solved by the permission given to member banks to rediscount with the Federal Reserve Banks commercial paper of approved category against which Federal Reserve notes could be issued. It was further realised that a single institution with its headquarters say in the East would be apt to be out of touch with conditions in the Middle West or the West Coast. It was therefore decided to have a system of twelve Reserve Banks serving twelve 'districts', into which the States were divided.

Analogy on geographical considerations might suggest that India would require at least as many Reserve Banks if they are to effect a direct contact with local conditions in the various districts. A reserve bank with its headquarters in Bombay is hardly in a position to understand a sudden development in moffusil areas, much less to take effective steps in time to counter such development.

Going, however, more closely into the question, it must at once occur to anybody that if India wanted a 'Central Bank' scheme, America is the last place in the world to supply a model ; and it will be found on a stricter examination that their plan neither carries out the 'Central Bank' idea nor the 'Federal' idea to its logical conclusion, and, in making a hopeless combination of the features of the two, ensures its earliest and completest failure.

Thus the commissioners propose that the Bank Act should include provisions, compelling every bank or banker transacting business in India, from a date to be notified by Government, to establish and maintain minimum reserve balances with the Reserve Bank equal to 10 per cent. of its or his demand liabilities to the public in India and 3 per cent. of its or his time liabilities to the public in India, a heavy penalty being imposed for failure to comply, practically involving the suspension of the business of the bank or banker till the minimum balance is restored.[1]

It may be noted at the outset that America at least has not ventured to introduce a provision in this form.

In America, three main types of banks operate ; the National Banks supervised and regulated by the central authority ; the state banks and trust companies functioning under the control of various States ; and the recently superimposed 'central' institution, the Federal Reserve Banks. While something approaching compulsion was applied to National Banks to enter the Federal Reserve System by a provision that the privileges they enjoyed

1 Para 161.

would be forfeited unless they accepted the new Act, no compulsion whatever was used in the case of state banks and trust companies. Even this compulsion was of a sort only as the National Banks had the choice of remaining in the system or shifting over to a state system if they elected. In their case, however, it was argued that the Government in granting them the power and privilege to operate under the protection and with the privilege of charters emanating from itself, naturally is justified in making these privileges contingent upon the acceptance of such conditions as it may deem proper.

At any rate those institutions who would elect to remain outside the system were free to do so, though naturally a strong inducement was offered in the shape of special advantages to those who wanted to be members of the new system, subject however to the acceptance of certain conditions they must fulfil.[1]

The particular provision, however, about reserve

---

1 Sec. 9 of the Federal Reserve Act :—Any bank incorporated by special law of any State, organised under the general laws of any State or of the United States, desiring to become a member of the federal reserve system, may make application to the Federal Reserve Board, under such rules and regulations as it may prescribe, for the right to subscribe to the stock of the federal reserve bank organised within the district in which the applying bank is located.

balances originated in the 'legal reserves' which the national banks were obliged to maintain by the terms of their charter before the passing of the Federal Reserve Act. It was the transfer of these,—the terms of transfer being considerably relaxed so that the banks may not suffer undue hardship—which was made compulsory by the Act in order to secure the necessary concentration of the 'decentralised' reserves of the national banking system; and in this respect the Act departed from the original recommendation of the Monetary Commission which had made this transfer voluntary.

In the case of India, the necessity of imposing a condition upon banks to maintain a minimum reserve has never arisen. These banks were never banks of issue; a number of them are doing sound business on lines laid down by the tradition of the English banking practice. It would not appear reasonable to oblige, say, the Bank of India or the Central Bank of India to maintain a minimum reserve balance. Considerations of neither safety, nor convenience, nor common sense would justify such compulsion.

Apart from any other consideration, there would be a fundamental objection on principle to such a proposal. In Canada, for example, the supposed benefits to the United States from the that their 'central' institution took and to which the Indian banking development can offer no parallel. Nor would this sort of a rigid bar upon direct dealings with the public appear to be working satisfactorily in America. Thus Dr. H. Parker Willis, who was intimately associated with Carter Glass in the conception and construction of the Federal Reserve Act and who further had an intimate knowledge of the working of the system as the Secretary of the Federal Reserve Board, records in his survey of the operation of the Act. "Cut off, as it naturally is, by the terms under which it exists, from direct contact with the borrowing public it has always been difficult for the system to make plain the true nature of its motives or objects, and to get from the rank and file of the public free and intelligent criticism or a sincere approval and support of its efforts."[1]

Nor would the discount policy of the federal reserve system appear to be efficient. Thus the Bank of England has a direct access in the open market, with the result that its bank rate policy is effective ; and if the market rate does not respond, the Bank can take measures that it shall, by going into the market and taking short loan money until the operators through shortage of borrowable funds

1 *The Federal Reserve System* p. 539.

are forced "into the Bank".[1] In the case of federal reserve banks, it is difficult to make the discount rate effective except in times of pressure when member banks are driven to the central institution for additional accommodation.

Thus Dr. Willis complains that it is a fact that not more than 50 per cent. of the national banks have at any time been discounters, while taking the whole number of members, it is probably true that a large percentage have never discounted at all, or at all events have done so only very sporadically ; that 'to one who reviews the discount rate history of the federal reserve system, the outstanding fact in the case doubtless is that there has been no time when the system could be said to be really the leader of the market or be able to make its discount rate "effective" for any considerable period' ; that 'closely connected with this failure to develop as a financial leader and with the unsuccess in building up an open market in which the "bank rate" would be "effective" must be noted the ill success that has been had in stimulating the growth of liquid paper in the American market' ; that 'when the emergency produced by war had passed, the failure of the system to develop a discount market or to exert as independent and courageous an

1 Cheminant, *Foreign and Colonial Banking Systems*, p. 37.

minimum reserve requirement induced Mr. Foster to introduce in 1890 a bill embodying this feature in the Canadian banking system. The Canadian bankers, however, carried the contest before the Privy Council and secured the exclusion of any provision for the reserve from the government bill.[1] It was argued that such a requirement would prove more of an injury than a benefit to the business community in times of stringency. A reserve which cannot be drawn upon in a crisis ceases to be a reserve. To use a military analogy, this type of reserve corresponds to a force which a commander is obliged to retain out of battle but which he is not allowed to use when his troops get into difficulty and need support.[2] One of the strongest arguments in favour of liquid reserves and banking upon general assets is found in the comparative calm which has reigned among Scottish and Canadian bankers when those of other countries have been shaken by panic. In periods of stringency, the Canadian banks, who had offices in the United States of America, it was found, came several times to the rescue of the New York money market, when the requirements of a rigid reserve law tied the hands of the American banks.

---

1 Conant, *History of Modern Banks of Issue*, p. 471.

2 Cheminant, *Foreign and Colonial Banking systems*, p. 32.

A further American analogy commissioners would appear to have adopted is that like the Federal Reserve Banks, the Indian Reserve Bank may have no direct dealings with the public.

In India, the difficulties of a Reserve Bank organised on a superficial American analogy would be insuperable. In the first place, a powerful body of bankers, such as Exchange Banks controlled from their headquarters outside India, may not care particularly to solicit the aid of the Reserve Bank. Among the joint stock banks registered in India, sound institutions are not so numerous as to ensure sufficient business to occupy its activities ; while there is an immense network of the indigenous banking system[1] about whose activities accurate information even is not available, apart from the utter hopelessness of an institution with its headquarters in Bombay ever succeeding in establishing a direct contact with it.

It was, however, the special American banking development which necessitated the peculiar form

1 About this, Sir Basil Blackett in his address before the Delhi University in Nov. 1925 remarked, "If the firms doing this class of business were included in our statistical tables, the comparison between the number of bankers in India and in, say, Japan, which is sometimes commented on to the disadvantage of India, would probably show, proportionately, at least as many bankers in India as in Japan. Unfortunately there is very little information available regarding indigenous banks".

influence as it should upon the distribution of credit has been notable'.[1]

The experience of South Africa in this connexion should prove useful. The scope of operations of the Reserve Bank of South Africa would appear to have been widened on the recommendation of Dr. Kemmerer and Dr. Vissering who remarked that, "A Central Bank possessing a monopoly of note issuing privilege and holding in its vaults the legal reserve money of other banks, in any country, would be a quasi-public institution, affected with a great public interest. The first duty of such a bank is to serve the public. This it does by conserving the money market by preventing undue credit expansion or undue credit contraction, by maintaining the monetary standard through regulating the supply of currency to the varying demands of trade and through assuring the public equitable rates of discount and exchange. To perform these functions properly, a Central Bank must be ready at any time to operate in the open market, in order, by so doing, to make its discount rate effective and thereby to enforce its policy ; otherwise the commercial banks, so long as they did not need to call upon the Central Bank for aid might refuse to

---

1 Willis. *The Federal Reserve System* pp. 1507, 1516, 1519, 1526.

follow its leadership and so prevent it from discharging its duties to the public," and again, "A second reason why a Central Bank should have reasonable powers of dealing directly with the public is to enable it to earn sufficient to cover its expenses, build up a reasonable reserve, and to pay adequate dividends on its capital during normal times when the market is outside thə Bank, in other words, when market conditions are such that the commercial banks are not making any demand upon the Reserve Bank for advance."[1]

The general systems of banking which reached a high state of development in the nineteenth century fall under three main types; the highly centralised systems of Europe; the independent charter banking system of which the Canadian banks offer the purest type; the modified free banking plan of which the American national banking system affords the illustration.

The Indian banking development, rightly or wrongly has occurred definitely along lines indicated by the first type. In the circumstances as they stand, the federal reserve plan would have as much or as little chance of success in India as the Imperial bank system would have in America.

In the light of the banking development in

---

1 *The Capital*, 2nd Sept. 1926.

India, Mr. Keynes' scheme compares favourably with the scheme proposed, especially as it was prepared after a careful study of the foreign banking systems and contains 'nothing more than an adaptation to Indian conditions of methods which have been tried successfully in a great many places.'[1] The scheme may require modification in details; but it offers a basis for utlising fully the existing machinery of the Imperial Bank system for the rôle which it is already fulfilling successfully to some extent, and for which it has undergone valuable preparatory training.[2]

As Sir Basil Blackett remarked in his address[3] before the Delhi University, the most important

---

1 Chamberlain Report, Annexe, p. 84.

2 In 1844, Peel, while defending the granting of a charter to the Bank of England in preference to a new central bank, remarked, "The true policy in this country is to work, so far as it be possible, with the instruments you have ready to your hand—to avail yourselves of that advantage which they possess from having been in use, from being familiar from constituting a part of the habits and usages of society. They will probably work more smoothly than perfectly novel instruments of greater theoretical perfection." Andréadès, *History of the Bank of England*, p. 288. Peel's faith in the Bank of England is justified by subsequent history. It is hardly necessary to point out that the charter did not 'decommercialise' the Bank. On the contrary, its power of direct dealings with the public has been an important lever for establishing control over the other banks.

3 November, 1925.

function which the Imperial Bank can perform is 'to be the bankers' bank for India linking up to itself and assisting the development of all forms of banking from *bottom to top.*' The valuable local knowledge, skill and experience from direct contact would contribute materially to the efficient performance of the function.

In spite of the handicap of having no right of note issue, the Imperial Bank has played an important part as a banker's bank in business centres. The development in branches has materially increased its opportunities 'in bringing not only sound banking facilities in parts of India where they were lacking entirely but of supplying a basis in reliance upon which private and co-operative banking could be built up.'[1]

No great banking development in India can take place by ignoring the indigenous banking system. If banking in rural areas is to be developed to the extent required, it will have to be by the recognition of the indigenous system, and its adaptation, rather than by its supersession by joint stock banks on western lines.

The Mahajans and Shroffs are apt to be criticised for their usurious methods and 'inhuman' practice of bleeding the poor ryots but, if the risks they

1 Chamberlain Report, Annexe, p. 79.

have to incur are considered, it would be discovered that they might not be as bad as they are painted to be and it is well known that, in the rural economy, the Sowcar fills a place from which even the co-operative banking cannot hope to dislodge him. About these bankers, Mr. Preston, Chief Manager of the Chartered Bank of India Australia and China and a Member of the Currency Commision remarks in the course of a review of Indian banking,[1] "To their lasting credit, however, it must be admitted that they founded a clan—the banker caste—whose traditions have for over a period of centuries descended from father to son, a caste one of the most honoured in the land of India, and whose morality with very few exceptions, was almost beyond reproach, and whose daily transactions, although there was never a written law to regulate or to give protection, rarely showed default".

In his address before the Delhi University, Sir Basil Blackett described the indigenous banking system in these terms. "At the lowest grade above the cultivator, stand the village money lender and the agent of the landlord. Then come the marwaris, mahajans, or professional moneylenders, frequently consisting of private family firms with ramifications

1 The Banking Supplement, the Financial News. The *Statesman* 29th August 1926.

over several districts. The names and forms of these banking concerns vary greatly from Province to Province. In more important stations where there are no banks on European lines, there are generally one or two such firms who afford the usual banking facilities, accept deposits, give over-drafts or cash credits, and provide remittance by drawing on branches of the firm elsewhere. Their cheques have, however, as a rule only local validity and remittance is more normally effected by money order or cut notes, Marwari firms making free use of the remittance facilities provided by Government in the shape of supply bills or telegraphic transfers. Representatives of such firms are generally treasurers of Government treasuries. The firms lend money to petty industrialists, local money lenders and landlords, but their business is inextricably mixed up with purchases of crops as well as of cloth, etc., and is to the highest degree personal and informal......The general feature of the existing system is thus a long chain of middlemen doing business varying in indefinable stages from that of a banker to that of a moneylender".

The Presidency Banks whose business has been taken over by the Imperial Bank had established a valuable contact with the indigenous banking system. Direct assistance to the vast trading reformed note issue would place additional funds in the hands of the Bank and would considerably strengthen the hold of the Bank upon the internal banking system.

As Mr. Keynes contemplated, the Bank must adopt a definite policy of encouraging to the greatest possible extent the *re-discount* business. "The Bank would have on its list certain banks and private native financiers of high standing who would be among its regular customers and for whom in general it would be prepared to re-discount freely. The power of re-discount might prove a powerful aid to the development of Indian joint stock banks on sounder lines than hitherto, and involve at the same time a valuable check on them. For admitting a bank to the re-discount list, the local manager of the Presidency branch would require, from time to time, to examine somewhat carefully, in confidence, the bank's position; and the risk of losing its position on the re-discount list might act, to some extent, as a deterrent to rash banking."[1]

The Bank, strengthened as its position would be by the reform of the note issue, could render invaluable service by pushing the circulation of notes and thus lay the foundation of deposit banking in moffusil areas.

1. Chamberlain Report, Annexe, p. 72.

The Imperial Bank by its branch development has special opportunities for pushing the circulation of notes and for popularising them by an increase in the facilities available for convertibility. For this work, the Reserve Bank would be practically useless, even less efficient than the present Government Department. It may not be feasible to accept a legal obligation at all the offices of the Bank. While such legal convertibility may be confined to a prescribed number of offices, other offices may be authorised to encash notes, whenever they can do so without embarrassment. With increasing experience it is possible that the occasions when they would not find it convenient to encash them would be rare. The notes, of course, would be legal tender, and must be accepted *in payment* by all branches of the Bank.[1]

A practical convertibility of this sort brought near the door of the agriculturist will be the most effective means of substituting a more profitable form for the present crude form of investment in metallic gold.

It is the lack of instruction which is the impassable barrier in the progress of deposit banking in the 'uninstructed'. No amount of Government assistance can cure this fundamental defect. The

1 Chamberlain Report, Annexe, p. 74.

community in India is not possible except in a few cases and it is in his capacity as a middleman that the Indian private banker proves of such great service.[1] The people with whom the Bank deals directly are for the most part large shroffs of good standing. "These men operate with their own capital and, generally speaking, it is only when they have laid out all their available capital in purchasing the *hundis* of other (and usually smaller) shroffs that they come to the Presidency Bank. The shroffs whose *hundis* the larger shroffs have purchased have probably also similarly financed other and still smaller shroffs or mahajans, and so on until we get down to the smallest flea of all, namely the village bania, or grain dealer or goldsmith".[2]

There is an elaborate and very efficient system of limits whereby the amount of bills discounted for each shroff is watched. "Put very briefly, the system is as follows. Shroff A is given in the Bank's register a limit of, say, 20 lakhs, and at the same time the names of the drawers of the bills purchased from him by the Bank are watched. The Bank may have purchased from A, say, 15 lakhs of bills, the drawers of which are B, C, D, E,

1 *The Indian Year Book.*

2 Annexure to App. A par. 3, Smith Report.

etc. If it is observed that shroff A has been purchasing rather too many bills from shroff D, who is of comparatively small standing, or about whom not much is known, A will be liable to be turned down, or if the fact has been noticed by the Head Office, the Branch will at once be told to go slow".[1]

The rates charged by the shroffs are usually based on the rates at which they in turn can discount the bills with the bank, and necessarily would vary according to the standing of the borrower and with the season. 'It may be said broadly that the *hundi* rate rises and falls with the Bank rate proper, though somewhat in advance of it, and naturally so, for one is a discount rate and the other a rate for day-to-day loans. Thus at the beginning of the busy season, the *hundi* rate would usually be higher than the bank rate ; the reverse being the case when the slack season is about to begin, so that the *hundi* rate may be said to be a sort of long-distance signal'.[2]

The 'foundation' of a strong central institution having a direct hold upon the financial system for enforcing a consistent bank rate policy is thus well and truly laid for the Imperial bank system. The

1 Annexure to App, A, par. 4, Smith Report.

2 Annexure to App. A, par. 6, Smith Report.

use of a cheque book is practically beyond the comprehension of the illiterate masses.

A currency note, next to the coin, is easily recognisable and, if readily convertible, affords the only means of replacing the coins and hoards, in existing conditions. The growth in the paper circulation in India concurrently with the increased facilities of convertibility clearly indicates that this is how the 'hoarding habit' may be tackled.

The Imperial Bank, charged with the function of note issue and enjoying Government support, provides the most efficient machinery for increasing the circulation of notes and developing the banking habit. The experience of other countries has demonstrated that it has, always, been 'the mission of the bank note to introduce deposit banking where it could not otherwise obtain a footing, to obtain the use of capital for the community without the direct and conscious action of the lender, and to provide a convenient substitute for metallic money'.[1]

The two most conspicuous steps in the development of modern banking methods have been the predominance of bank note issues in the early stages and decline in their importance as the mechanism of the cheque and deposit system has grown in favour. While in big centres, a bank note has

---

1 Conant, Money and Banking, ii p. 279.

a tendency to approximate to a convenient certificate of coin, in the remote districts it acts as a pioneer of credit and the apostle of deposit banking. "Under such conditions the introduction of banking methods would be extremely slow but for the issue of notes. As Bagehot points out, 'No nation as yet has arrived at a great system of deposit banking without first going through the preliminary stage of note issue.' Thus the notes of Bank of England and the country banks paved the way for the introduction of the deposit system in that country and the notes issued by the Scotch banks gradually drew almost every penny of available capital in Scotland into the channels of circulation. A similar experience was that of the independent departmental banks in France...... ..The history of the departmental banks which succeeded in several cities where branches of the Bank of France could not obtain a profitable footing, is one of the most striking proofs of the value of the bank-note issues in affording credit and extending facilities for business".[1]

Even if, therefore, Imperial Bank must perform successfully the function of the 'initiator of banking facilities', it is indispensable that it should be a bank of issue.

---

1. Conant, Money and Banking, ii. p. 280. The departmental banks were merged in the Bank of France in 1848.

The principal functions which a Central Bank must perform may thus be enumerated. It must have a complete control over the credit policy and this depends a good deal upon the hold which it has upon the financial system of the country. It should have, if possible, the sole right of note issue, or at any rate the sole right of issue of notes which are legal tender. As a general rule it acts as a banker for Government and its position is immensely strengthened by the support of the state. The capital, however, is subscribed from private funds, and dividend is paid on this to the shareholders.[1] In all cases Government is strongly represented on the Board of Directors in order to ensure a national, as distinguished from a purely commercial, policy in a national institution.[2] It should scarcely be

1 Mr. Keynes recommends a dividend of 10 per cent to the shareholders, and a further share in the divisible surplus after provision for reserve. By the Federal Reserve Act, the dividend is restricted to 6 percent. in the first instance; but in the federal reserve system, *banks* are stock holders and in their case it was considered that banks had no right to claim more than the normal rate of return from current bank investments in securities of a high character, especially as it was not necessary for banks to set aside a part of their capital for this subscription and they could devote a part of their current funds to it.

1 Mr. Keynes' scheme, thus, gives Government the power to nominate the entire nucleus of the Central Board. The Federal Reserve Board similarly consists of ex-officio and nominated members entirely. It is of interest that President Wilson made a

necessary to point out that the character of the business of such a bank must be of the soundest, its investments should be confined to the securities of its own Government or local authorities, with the possible exception of international securities of the highest class and the bills which the Bank discounts must be of a limited usance and must bear at least two good names and must be those arising out of a genuine commercial transaction.[1]

The restrictions are the price that the Bank pays for enjoying the special privileges conferred

---

firm stand and insisted on this provision inspite of the opposition of bankers. Brussels and Genoa conferences, however, recommended as a result of the war experience that 'Banks, and especially Banks of Issue, should be free from political pressure, and should be conducted solely on lines of prudent finance'. If this view is taken to be correct, the composition of the governing Boards suggested by the commissioners would be better.

1 American experience, in this connexion, is very instructive. The American internal trade is financed by single-name paper which is practically an unendorsed, promissory note. The note was not even drawn for a 'sum certain', the amount being filled up subsequently. A large quantity of the 'best' American paper is represented by such notes. The framers of the Federal Act, on the analogy of Europe, suggested that a definite attempt should be made to foster the two-name paper. The merchants warned that, if required by law, or by regulation of the Board, such paper could be 'manufactured' to order but that it did not mean that it would be superior to what the 'settled' business practice in America had favoured. Subsequent experience justified this warning. It was found that this gave rise to a commercial paper of distinctly a second class impairing the general liquidity of the financial system of the country. The Federal Board had ultimately to give up the discrimination in favour of the two-name paper.

The Imperial Bank has, however, not experienced this difficulty. The American experience at any rate gives an emphatic warning against novel experiments with the financial system of a country. This applies to the proposed abolition of cash credits.

upon it in comparison with the other commercial banks. Incidentally these restrictions operate by preventing the central institution from entering into active competition with them.

The very fact that the Imperial Bank would appear to be chafing under the restrictions imposed upon the types of business it can undertake, coupled with the fact that there is no outcry from the other banks about competition from it, would suggest that the restrictions are operative.

The commissioners, however, propose that the Imperial Bank should be freed from the restrictions which its charter imposes, on the ground that, if a new Central Bank is set up, there is no reason, 'why the Bank should not be as free and unencumbered in its sphere of activity as any other commercial bank.'

If, however, the Imperial Bank chooses to be free and unencumbered as any other commercial bank, it can do so by placing itself absolutely on a level with the other banks.

The cardinal point in the policy of any Central Bank is its strict impartiality. If it has any privileges to confer, they must be on definite terms and any commercial bank which fulfils the necessary conditions must be admitted to the privileges. For this reason, a special provision is

introduced in Sec. 4 of the Federal Reserve Act,—
'Said board[1] shall administer the affairs of said bank fairly and impartially and without discrimination in favour of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements, and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks."

The commissioners, however, propose to set up a disastrous 'Pet Bank' system which destroys the basic idea of their scheme. If the new Reserve Bank is rendered innocuous to the extent of reducing it to lifelessness, the other commercial banks would have to compete with a dangerous and powerful rival in the new Imperial Bank freed from all restrictions and enjoying a special patronage of Government and the Central Institution.

Not content with this, the commissioners further propose[2] that the Imperial Bank's shareholders should be given the first opportunity of subscribing for the capital stock of the Central Bank proposed.

1 i.e. the board of directors for the various Reserve Banks.

2 Para 91.

The shareholders of the Imperial Bank would be singularly lacking in business acumen if they do not avail themselves of a concession which gives them the proprietorship and control of the Central Institution. If it is realised that 'a predominant majority' of members of the Governing Boards of the new Bank would 'derive their mandate from the shareholders,' the effect of the proposal may be to set up a mild imitation of the famous Doctors' Commons, where a set of gentlemen may be called upon at one period to plead for loans and at another to grant them. Even if it is provided that governorship in one institution should be a permanent disqualification for service on the controlling Boards of the other, it will be too much to hope that governors responsible to the same set of proprietors will regard the interests of the two institutions as anything but identical.

A great commercial bank, freed from restrictions, enjoying special privileges, and with the central institution in its leading strings would rout the other banks from the field. The result may be that the Indian firmament would be exclusively occupied by a double star, the new institution revolving its faint existence round its brilliant companion. It may, well, be, however that the radiance of even this Sirius, with the other and lesser lights put out, may not fill the sky.

APPENDIX A.

MEMORANDUM BY MR. J. M. KEYNES ON PROPOSALS FOR THE ESTABLISHMENT OF A STATE BANK FOR INDIA, (IN COLLABORATION WITH SIR ERNEST CABLE).

I

In preparing the scheme, the following objects were kept in view :—

(i) To combine ultimate Government responsibility with a high degree of day-to-day independence for the authorities of the Bank.

(ii) To preserve unimpaired authority in the executive officers of the Bank, whose duty it would be to take a broad and not always a purely commercial view of policy, and at the same time to make use of the commercial instincts and commercial knowledge of representatives of shareholders.

(iii) To maintain in the day-to-day management of the Bank the high degree of decentralisation to which great importance is rightly attached in the case of so large a country as India.

II

OUTLINE CONSTITUTION.

(i) The supreme direction of the Imperial Bank must be vested in,

(a) a Central Board of three members

(1) The Governor of the Bank (who shall be the Chairman).

(2) The Deputy Governor,

(3) A representative of the Government who may be the Financial Member, the Member for Commerce and Industry, or the controller of currency,

assisted by three or more Assessors, who shall be the Managers of Presidency Head offices or their Deputies. The Assessors would have a right to attend any meeting of the Central Board but shall not vote.

(a) A regular dividend of 10 per cent., on the ordinary capital to be distributed among the shareholders, being made up to this amount from the reserve, if the net profits fall short of 10 per cent.

(b) Of the remainder, after payment of 10 per cent., two-fifths to be transferred to the reserve when this remainder is not more than 20 per cent of the capital, and one-third when it exceeds 20 per cent.

(c) The divisible surplus, after deductions (a) and (b) shall accrue to the shareholders upto an additional 5 per cent, of their capital, and thereafter to the shareholders in the proportion one-third, and to the Government in the proportion two-thirds.

(ii) The normal continental arrangement is one in which the Government receives its advantage partly by the free performance of services on the part of the Bank, partly by a tax on the note issue, and partly by a share in the profits. The Bank should perform the following services without remuneration :—

(a) to purchase gold bullion at a notified rate to issue (but not mint) gold and silver, to manage the note issue and the custody of the Paper Currency Reserve.

(b) to accept payments and make disbursements for Government (Local and Imperial)at branches.

(c) to manage the Government debt in India.

(iii) The Note Issue should be regulated on the following lines :—

(a) Up to 40 per cent. of the gross circulation of notes may be held in a fiduciary form without payment of tax

(b) Up to 60 per cent. of the gross circulation, may be held in a fiduciary form, on payment to the Government at the rate of 5 per cent. per annum on the excess of the fiduciary form above 40 per cent.

(c) The fiduciary form shall *never* exceed 60 per cent. except in emergency when the Bank Act is suspended by the Government.

The present form and appearance of the notes must be preserved, with the possible addition of the name of the Bank and the counter signature of the officer employed to supervise the reserve. As by the provision of a separate Issue Department, specific assets are allocated to cover the issue, this does not lay on the Government any real additional burden and would allay suspicion by emphasizing the ultimate guarantee of the solvency of the note issue resting upon the Government.

IV—ADVANTAGES OF A STATE BANK.

After mentioning the advantages, such as the abolition of the Independent Treasury System and a consistent bank rate policy, which the institution of the present Imperial Bank has already secured, Mr. Keynes enumerates others which are of more immediate interest to-day.

(i) A Bank, responsible for the management of the note issue, has greater opportunities than are open to Government for pushing the circulation of notes and for popularising them by an increase in the facilities available for convertibility.

(ii) The increase of branches, which the union of Government and banking business should promote, would gradually bring sound banking facilities to many parts of India, where they are now almost entirely wanting, both directly and by supplying a basis, in reliance on which private and co-operative banking could be built up.

(iii) In addition to the use of Government balances through their deposit in a central institution, a considerable amount of funds is made available by the reform of note issue.

(iv) The introduction of re-discount facilities, while probably not of the first importance in the

The Governor shall be appointed by the King for periods of 5 years on the recommendation of the Secretary of State, and shall be removable in like manner.

The Deputy Governor shall be appointed by the Viceroy on the nomination of the Governor of the Bank and of the Government representative on the Central Board.

These officers should invariably be persons of commercial and banking, not administrative or official, experience, and should be appointed, so far as may be possible or convenient from the staffs of the Presidency Offices.

(b) Within the limits of the Bank Act, the Central Board shall have absolute authority.

The representative of the Government, however, shall have discretionary power (for use in emergencies only) to suspend the execution of any decision pending a report to the Viceroy who would have an ultimate right of veto.

(c) The Central Board shall have no direct dealings with the public.

(ii) Each Presidency Head Office shall be under the direction of

(a) a Presidency Board consisting of

(1) The Manager (who shall be the Chairman)
(2) The Deputy Manager
(3) A representative of the Local Government
(4) Three (or four) unofficial members, elected by the shareholders on the local register.

(b) Subject to the general direction of the Central Board, the Presidency Boards shall have authority to transact business of the following description :—

(1) To discount Indian trade bills, of maturity not exceeding six months, subject to a minimum rate arranged from time to time in consultation with the Board.

(2) To rediscount sterling trade bills, bearing the endorsement of another bank, subject to a minimum rate arranged from time to time in consultation with the Central Board, and subject to daily report to the Central Board.

(3) To make interest-bearing loans (subject to a minimum rate etc.), for periods not exceeding six months, against such kinds of security as is permitted by the Bank Act.

(4) To buy and sell in India, subject to daily report to the Central Board, gold bullion and such bonds and securities as are authorised by the Bank Act.

(5) To provide trade remittance for customers to all parts of India, and private remittance to London subject to certain conditions.

(6) To accept interest and non-interest bearing deposits, subject to a maximum rate, etc.

(7) To accept valuable goods for safe keeping.

(8) To open, staff, and control branch banks at suitable centres.

(iii) The following are the other functions which the Bank must perform :—

(1) It will act as Government banker, holding the treasury balances.

(2) It will manage the note issue on the terms outlined, and, with the exception of certain payments to the Government, shall enjoy its profits.

(3) It will manage the Government debt in India.

(4) It will perform remittance operations for the Government and for its private customers. The Bank must, however, be precluded from buying sterling bills in India, *except from other banks,* and in England these bills may be rediscounted only at the Bank of England.

III

Division of Profits and Regulation of Note issue.

(i) The annual net profit of the Bank, after due allowance for depreciation, etc., should be dealt with in the following manner :—

(2) To discount, buy and sell bills, payable outside India for and from or to Banks, subject to the directions of the Governor General in Council.

(3) To make loans and open cash credit accounts against the security of—stock, funds, and other securities (other than immoveable) in which trust money may be invested; securities of state-aided Railways notified by Government; debentures or other securities of district boards; goods which, or documents of title to which are deposited with, or assigned to the Bank; accepted bills of exchange or promissory notes endorsed by the payees and joint and several promissory notes of two or more persons unconnected with each other; fully paid shares and debentures of companies with limited liability, or immoveable property, as *collateral security* only if the original security is of the first four types, mentioned in the paragraph.

(4) To buy and sell gold and silver coined or uncoined.

(5) To receive deposits and keep cash accounts on such terms as may be agreed upon.

(6) To invest the funds of the Bank in securities mentioned in paragraph (3), of the first three types only.

(7) To make, issue, and circulate bank post-bills and letters of credit, payable in India or Ceylon.

(8) To accept the custody of valuable goods,

(9) To sell and realise all kinds of property, moveable or immoveable, which may come into the possession of the Bank, in satisfaction of its claims,

(10) To do pecuniary agency business on commission, or agency work in connexion with buying and selling of securities or shares of a public company,

(11) To provide remittance for private constituents for *bonâ fide* personal needs and for the purpose may buy bills of exchange payable outside India, of usance not exceeding six months;

(12) To act as banker[1] for Government and do other business entrusted by the Government in accordance with the terms of any agreement entered into.

(13) To open, staff, and control branches opened at suitable centres.[2]

(14) To do other business incidental to the above-mentioned purposes.

The Bank is *not* authorised to transact the following description of business :—

(1) At its London office, the Bank shall not open cash credits or keep cash accounts for or receive deposits from any person who is not, or has not been, within three years last preceding, a customer of the Bank in India or Ceylon.[3]

(2) It shall not make any loan or advance
   (a) for a period longer than six months, or
   (b upon the security of stock or shares of the Bank
   (c) upon the security of immoveable property, except under specified conditions in the relevant section indicated, in Part I of Schedule I.

(3) No bill, having a maturity exceeding six months or not carrying on it the several

1 Sec. 10.
2 Sec. 12. Within five years, the Bank was to open one hundred new branches, an undertaking fulfilled by the Bank. Sec. 10 (b).
3 Sec. 9.

immediate future, might greatly aid the eventual development of Indian banking on the most desirable lines which European experience has so far evolved.

APPENDIX B.

THE IMPERIAL BANK ACT.

ACT XLVII OF 1920.

OUTLINE CONSTITUTION.

(i) The supreme direction of the Imperial Bank is vested in

(a) a Central Board[1] consisting of the following Governors,

(1) the presidents and vice-presidents of the Local Boards established by the Act.

(2) the Controller of Currency, or such other officer as may be nominated by Government,

(3) such number of persons, not exceeding four and not being officers of Government, as may be nominated by Government. They will hold office for a year, and may be re-nominated.

(4) the Secretaries of the Local Boards,

(5) Managing Governors, not exceeding two appointed by Government after consideration of recommendations of the Central Board, for the period as directed by Government.

(6) If any Local Board is established subsequently, such number to represent it as the Central Board may prescribe.

---

1 Sec. 28.

Governors mentioned in (2), (4) and (6) may attend meetings of the Central Board and take part in the deliberations, but have no right to vote.

(b) The Governor General in Council shall have power to issue instructions[1] to the Bank in a matter which, in his opinion, vitally affects his financial policy or the safety of Government balances, and, in the event of the Bank disregarding such instructions, may declare the agreement with the Bank to be terminated.

(ii) Local Boards shall be established[2] at Bombay, Calcutta, and Madras and such other centres as may be sanctioned.

(a)—(1) The president and vice-president shall be chosen at the first meeting of the Local Board every year from among its members. No member can be so chosen twice in succession.

(2) Every year, two members longest in office, shall go out of office. The retiring members are eligible for re-election.[3]

No person may be a Governor or a member of the Local Board, who is connected with a joint stock bank, or is a salaried officer of Government, or along with another if both are partners of the same firm, or directors of the same private company, or agents one of the other, except in cases exempted under the Act.[4]

(b) The Local Boards shall have power to transact all the usual business of the Bank, subject to the general control of the Central Board.[5]

The Bank is authorised[6] to carry on and transact business of the following description :—

(1) To draw, accept, discount, buy and sell bills of exchange and other negotiable securities payable in India or Ceylon,

---

1 Sec. 10 (2) (a). 2 Sec 25. 3 Reg. 43 and 44. 4 Reg. 39.
5 Sec. 26. 6 Schedule I.

responsibilities of at least two persons or firms unconnected with each other in general partnership, may be dealt with by the Bank.[1]

APPENDIX C.

The memorandum submitted to the currency commission.

Note. This was the written statement submitted by the author to the currency commission. It is mainly occupied with an analysis of the monetary policy which brought about the artificial rise of the rupee and with measures for relief pending return to normal conditions.

The currency commission met formally at Delhi on 23rd November 1925 and issued the following questionnaire.

(1) Is the time ripe for a solution of the problems of Indian currency and exchange by measures for the stabilization of the rupee or otherwise? What is the comparative importance of stability of internal prices and in foreign exchanges? What are the effects of a rising and a falling rupee and of a stability of high or low rupee on trade and industry including agriculture and on national finance?

(2) In relation to what standard and at what rate should the rupee be stabilised, if at all? When should any decision as to stabilisation take effect?

(3) If the rate selected differs materially from the present rate how should transition be achieved?

(4) What measures should be adopted to maintain the rupee at a rate selected? Should the gold exchange standard system in force before the War be continued and with what modifications if

1 Schedule I Part II

any ? What should be the composition, size, location, and employment of a Gold Standard Reserve ?

(5) Who should be charged with the control of note issue and on what principles should control or management be transferred to the Imperial Bank of India and if so, what should be the general terms of transfer ? What provisions should be made as to the backing of the note issue ? What should be the facilities for encashment of notes ? What should be the policy as to issue of notes of small values ?

(6) What should be the policy as to minting of gold in India and use of gold as currency ? Should obligation be undertaken to give gold for rupees ?

(7) By what method should remittance operations of the Government of India be conducted ? Should they be managed by the Imperial Bank ?

(8) Are any, and if so what, measures desirable to secure greater elasticity in meeting seasonal demands for currency ? Should any, and if so what conditions be prescribed with regard to issue of currency against *hundis* ?

(9) Should any change be made in the existing methods for purchase of silver ?

In the written statement the exact order indicated above has not been adhered to ; but an attempt was made to answer all the important points of enquiry.

---

1. The time is certainly not ripe for the stabilisation of the rupee if this means stabilisation at the level of 1*s.* 6*d.* (gold). But the time for the formulation of a definite monetary policy is long past. When the conclusions of the majority report of the Smith Committee were disproved by later developments, the only procedure was to take more seriously the minority report of the only

member of the Committee whom events proved to be in the right. Had this been done, the present difficulty would not have arisen.

2. Stability in internal prices is more important than stability in exchange. This can be achieved only by linking a currency definitely to a standard. While gold may not be an ideally perfect standard of value, there is no practical alternative to it by which its use as a monetary standard could be dispensed with, unless silver is utilised as a last resort.

Stability of exchange is besides a meaningless quest. The rate of exchange of one currency in terms of another would reflect changes in the purchasing power of *both*. Fluctuations in exchange rates in so far as they arise from conditions prevailing in other countries would be beyond Indian control.

Fluctuations in the value of the unit of currency in terms of commodities and services, where the term "fluctuation" must be held to include a continuous rise or a continuous fall also,—are undesirable in the interest of trade,—especially the internal trade which is more important than the foreign,—and industry including agriculture The evidence of index-numbers so far as it goes indicates that the rupee has been rising since 1920, in terms of commodities, in spite of apparently contradictory exchange movements. The rise, however, should be regarded as artificial in so far as it is due to a "relative contraction" of the currency in regard to the expanding needs of commerce. The distress of important Indian industries may be referred to this process of "deflation."

While a falling pricelevel is in the interest of consumers, it has to be realised that a consumer is also a producer. It serves little purpose to tell an agriculturist that he has to pay less for the commodities he buys, if the price of his produce falls simultaneously, especially as he has to pay the same amount in taxes from the reduced price realised for his produce. This has only the effect of increasing the burden of taxation on the key industry of India.

The only cheapness that matters in the interests of a consumer is that brought about by abundant supplies from increased production, and *not* what is brought about by an artificial control of the money supply, which is besides injurious to production.

A "real" rise in the value of the monetary unit would be reflected in a fall in the cost of production as well as the prices of commodities. Goods and services should be affected equally by a change in the value of the monetary unit The evidence as regards the movement of wages and salaries is clearly against such a conclusion.

The rise of the rupee in terms of goods is artificial in so far as it has resulted from an artificial limitation of currency, and temporary in so far as it does not appear to have affected services. It is urgent in the interests of the country that this "deflation" must cease, and a provision be made for an automatic increase in currency in accordance with the needs of commerce and industry.

This reversal of the policy of "deflation" should not be interpreted to mean "inflation". Not every addition to currency is inflation. A state of "inflation" commences only at the point where currency is forced on trade *beyond* its actual requirements. A sound monetary policy also postulates an expansion of currency provided this expansion is in response to the legitimate needs of commerce.

3. In so far as this artificial process of "deflation" is responsible for the rise of the rupee in terms of goods, it is also responsible to that extent for the rise of the rupee in terms of gold. Probability would indicate that the rise in terms of gold has been further exaggerated on account of special circumstances affecting gold.

It will be recalled that temporary causes which made *sterling* cheap brought about a rise in the sterling value of the rupee in the latter half of the year 1921,—a rise which reached the height of 1*s.* 5½*d.* in September 1921—though such a rise was not warranted by trade conditions. It will be further noted that the rate of exchange found its natural level after a period of about 10 months, though the official policy stood aloof from a commitment direct or implied.

A possibility cannot similarly be put altogether out of account, that causes, equally temporary, might have made *gold* cheap thus bringing about a rise in the gold value of the rupee In June, 1924, the rupee was only 1*s*. 3*d*. (gold). It was in August, 1924, that a precipitate rise began carrying it to 1*s*. 4*d*. in a month and to 1*s*. 5*d*. at the end of the year.

The world movement of prices in terms of gold has still to declare itself. It will be singularly unwise to base a permanent policy, taking the present world conditions regarding the relation of gold to commodities as normal for all times. It will be a mistake to discount authoritative opinion in Europe about the probable appreciation of gold in the future.[1]

India is not alone in the violent rise of its monetary unit in the exchange market. A policy of conscious currency and credit restriction pursued in Denmark and Norway had its inevitable reaction on the external value of their respective currencies, providing for the development of a considerable volume of bull speculation and leading to the distress of the industry and trade. A general desire, in favour of a return to the pre-War gold

1 It would be useful to enquire of those who favour the present level of 1/6 as warranted by the Indian and the world price-level, on the strength of the now fashionable doctrine of the purchasing power parity,—whether the present world price-level is normal, and the present Indian price-level is natural as a result of a natural monetary policy,—and whether they will recede from their position if their conclusions are falsified by a change in these conditions. A stable exchange can only be indicated by a stable equilibrium resulting from normal conditions prevailing in the internal or world prices.

A host of theorists were ready to prove the Smith Committee to be absolutely in the right in making their recommendations. But where are these recommendations and where are *now* these theorists ?

parity has probably reconciled these countries to such a policy.

In India, the element of the bullish sentiment[1] would appear to derive implied sanction from the official policy and this combined with the process of deflation has carried the rupee beyond its pre-War gold parity.

What, however, is very important to note is that India stands absolutely alone in its currency unit commanding a premium—and this, too, of $12\frac{1}{2}$ per cent.—over its pre-War gold parity. Other nations financially and commercially stronger than India have been content to attain, or maintain their pre-War gold parity. India will be very unwise to adopt a different policy, especially after her experience of what followed from the recommendations of the Smith Committee.

---

1 Apart from a purely bullish sentiment there is such a thing as a psychological factor in exchange movements. The Financial Correspondent of the *Capital* thus commented (14th May 1925) :—

> "There are shrewd analysts who deduce from present conditions that the exchange banks are overbought,—an assumption as difficult to establish as it might be to rebut, inasmuch as a definite judgment upon so interesting a possibility would not only require a very precise definition of terms, but a closer dissection of bank operations than detached observers can hope to obtain. A comparison of bank calculations at the beginning of the present year as against the actual course of trade, would certainly afford interesting reading, but partially on that account, it is not likely to be forthcoming. Trade movements and prospects —in themselves difficult to estimate—are further complicated, especially in so abnormal a period as is now operative, by mental processes at the same time so obscure in their trend, and so important in their effects, as to make what may be called the 'psychological factor,' in exchange operations, often the decisive element in the situation. To take a concrete, though small, example. Bills paradoxically are generally most plentiful when rates show a tendency to rise. The reason is fairly clear. As long as rates are stable, or have a tendency to drop, bills are held back in the hope of better terms. Immediately a rise reveals this hope to be vain, there is a rush to effect transactions before rates show a further worsening. And the same alteration of hopes

4. A declaration of the policy of adhering to the pre-War gold parity need not mean an artificial interference with the market involving the "shepherding" back of the rupee from the present level of 1*s*. 6*d*. to the level of 1*s*. 4*d*. The only immediate step is to remove *any* artificial interference that may exist at present and provide natural conditions to enable the rupee to find its natural level.

In spite of the remedial measures adopted by the Government, the fundamental situation remains unaltered that at present there is nothing in the nature of an automatic system whereby the country can obtain currency when required. Nor does the cash balance with which the Imperial Bank commenced the present exporting season suggest an improvement upon the position of the preceding years as the following comparison will bring out.

---

and fears is visible continuously throughout the whole range of exchange operations. A general apprehension that a particular situation in, say, exchange, is likely to develop will often produce so strong a reaction as to give exchange when the time comes, quite a different direction."

"We may assume that the British Chancellor is counting very heavily on this psychological factor in relation, for instance, to the re-establishment of the pound. Much of the present strength of sterling undoubtedly derives from long-nourished expectations of State action, and had this not been forthcoming, it is fairly certain there would have been a prompt reaction. Confidence would have disappeared, and sterling would have slumped. Actually Confidence has been further strengthened, and sterling continues to improve. One may calculate similarly that were the Government of India to aver its conviction that exchange would stabilise at 1*s*. 5*d*., there would, probably, be at once a movement *in that direction*. 'What may happen,' becomes, in such circumstances, almost as important as 'what *has* happened.' There is a constant effort to discount the future."

For this reason, I am obliged to call the implications of some pronouncements and acts of the Finance Member and the Government of India as unfortunate, in view of an unprejudiced examination of the currency situation by this Commission.

The Cash Balance of the Imperial Bank in the last week of October :—

	Lakhs of Rupees.
1922-23	33,46
1923-24	36,34
1924-25	21,55
1925-26	24,96

In the able memorandum (July, 1924) submitted by the Committee of the Bengal Chamber of Commerce, two methods were mentioned by which provision for the expansion of currency was possible, one being the issue of what may be termed *ad hoc* Treasury Bills. An expansion of currency by means of these would involve what is commonly known as inflation in the worst meaning of the term and the Committee therefore did not recommend it. The other method was by the deposit of gold or sterling securities in the Paper Currency Reserve.

A singular objection, however, was raised by the Government of India to the latter method. "Your Committee suggest that this should be done by the purchase of sterling at the market rate then ruling and the issue of currency against sterling so purchased. If literally interpreted and carried to its logical conclusion, this formula would have the result of driving the sterling value of the rupee continually downwards," the inference thus being that in the view of the Government the sterling value of the rupee must be maintained though the needs of the country in the way of currency might go unsatisfied.

This reveals a monetary policy, fundamentally unsound. The paramount consideration in issues of currency—in the words of the Committee—should be that the supply must be adequate to the requirements of the country.

The interests of a country cannot be sacrificed to a high exchange policy.

In so far as the present level of exchange is in pursuit of this policy, it is artificial and, I submit, in the interests of India, this policy should be reversed. It may mean that the rate of exchange may sag in consequence. But it is desirable that the rate of exchange should find its natural level, *whatever this might be.*

I am aware, a fall in exchange may mean difficulty in the budget for the Finance Department. But it is unsound finance to rely upon the benefit—always precarious - of an artificial rise in exchange. The Retrechment Committee which advised the Government of India had suggested other remedies for attaining equilibrium between the revenue and expenditure. The normal means of balancing the budget is reduction of expenditure

But for the expectations of high exchange, which it would be impossible to deprecate in too strong terms, the alarming growth in the sterling expenditure since the war would have been impossible. This growth was regarded as being so serious that the Associated Chambers, which met in December, 1923, passed a resolution, "that in view of the onerous nature of the external compared with the internal debt, this Association requests the Government of India to restrict its external borrowing as far as possible." In this connection, attention may be drawn to the cautious and conservative policy in finance which obtained before the war.

The only sane monetary policy at present is that while adequate provision should be made for the expansion of currency in accordance with the legitimate requirements of the country, exchange should be allowed to find its natural level. The only modification that I would suggest in the proposal of the Committee of the Bengal Chamber is that currency should be issued against the deposit of *gold*, both in India and in London, at the actual gold import point at the market rate. This will have the very desirable result of attracting gold into the currency reserve from the large imports which have been a feature for the last three years With a strengthened gold reserve, India will be in a stronger position to effect a transition to the full gold standard at the appropriate moment—this might be a year hence and at the most two years. With the further resources of the Gold Standard Reserve, India possibly may not have to ask for assistance in the shape of gold from the gold standard countries for effecting this transition. Again there is that other "secret" rsserve in the Paper Currency Reserve where gold and other securities have been valued at the rate of Rs. 10.

5. The note issue should be transferred to the Imperial Bank of India. As to the terms of the transfer, the memorandum submitted by Mr. Keynes and published as an annexe to the Chamberlain Report may be taken as the basis for discussion.

It should be possible to arrange for the encashment of notes at all the branches of the Bank. This may mean in the beginning some sacrifice on the part of the Bank. But the Bank has been earning a very high dividend for a number of years and can afford to make the sacrifice in the general interests of the country. Possibly the increased income on account of the enlarged scope of the Bank may render such sacrifice unnecessary.

However, even if it is necessary, the sacrifice is worth while. It will bring convertibility near the door of the agriculturist and may materially affect the up-country circulation which at present is probably predominantly metallic. It will provide a real line of advance for attacking the hoarding habit. A bank note is the forerunner of the banking habit.

On account of the wear and tear to which it is subjected in small retail transactions, a paper-note has to be renewed often. The cost of this renewal would make it questionable whether a small paper-note is really a cheap circulating medium. For small retail transactions, a metal coin has a distinct superiority over a paper substitute.

6. Mints should be open for the coinage of gold. The choice of the gold coin should be made after careful consideration of the denominations of the existing paper currency which will be ultimately convertible into gold.

ERRATA.

Page	Line	For	Read
1	7	desplays	displays
37	5	Balckett	Blackett
49	15	indespensable	indispensable
60	3 n.	correspondance	correspondence
71	12	for	far
86	8	utlising	utilising

INDEX NUMBERS OF WHOLESALE PRICES IN 20 REPRESENTATIVE COUNTRIES.

The Economist and the Labour Gazette.

	India (Bombay).	Japan.	China (Shanghai).	Egypt (Cairo).	United Kingdom Board of Trade.	Switzerland.	Belgium.	France.	Italy (Bachi).	Spain.	Holland.	Denmark.	Sweden.	Norway.	Germany.	Poland.	Czecho-Slovakia.	Canada.	U. S. A. Bureau of Labor.	Australia.
1913 Average	..	100	100	..	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
1914 "	100	96	..	100	..	..	..	102	..	..	109	..	116	115	..	..	..	102	98	106
1915 "	..	97	..	102	..	..	..	140	..	..	146	..	145	159	..	.	..	110	101	147
1916 "	..	117	..	124	..	..	..	188	..	..	224	..	185	233	..	..	..	132	127	138
1917 "	..	149	..	169	..	..	..	262	..	..	276	..	244	341	..	..	..	179	177	153
1918 "	236	196	..	207	..	..	..	339	409.1	207	373	292	339	345	..	..	..	199	194	178
919 "	222	236	..	226	..	..	..	356	..	..	304	..	331	322	..	..	..	209	206	189
920 "	216	259	152	299	307	..	..	509	..	..	292	..	347	377	..	..	..	244	226	228
1921 "	199	200	150	180	197	191·2	366	345	577·5	190	182	178	211	298	4,217	57,046	..	172	147	175
1922 "	187	196	146	146	159	167·5	367	327	562·3	176	160	181	162	233	205,417	72·5	1,334	152	149	162
1923 "	181	199	156	131	159	180·6	497	419	574·6	172	151	210	157	233	140·1	85·4	977	153	154	179
1924 "	182	207	154	143	166	174·6	573	489	585·0	183	156	234	155	269	146·9	109·7	997	155	150	173
" July	184	195	152	132	163	..	..	481	..	..	151	..	148	271	..	..	..	153	147	171
" August	184	200	149	143	165	..	..	477	..	..	151	..	152	274	..	..	..	157	150	169
" Sept.	181	207	149	147	167	..	..	486	..	..	158	..	153	275	..	..	..	154	149	170
.. October	181	213	153	156	170	..	..	497	..	..	161	..	162	276	..	..	..	157	152	171
" Nov.	176	214	155	158	170	..	..	504	..	..	161	..	162	277	..	..	..	158	153	171
" Dec.	176	214	157	156	170	..	..	507	..	..	160	..	163	278	..	..	..	161	157	173
1925 January	173	214	160	157	171	..	..	514	..	..	160	..	164	279	..	..	..	165	160	171
" February	173	210	159	161	169	..	..	515	..	..	158	..	164	281	..	..	..	165	161	170
" March	171	204	160	155	166	..	..	514	..	..	155	..	164	276	..	..	..	162	161	168
" April	165	202	159	154	163	163·0	538	513	658·1	190	151	..	160	267	142·3	119·4	1,006	157	156	166
" May	164	199	158	151	159	161·9	537	520	659·8	191	151	..	158	260	140·6	118·	998	159	155	167
" June	160	200	157	150	158	160·6	552	543	682·6	187	153	206	159	258	142·6	119·3	1,009	159	157	170
" July	158	198	163	151	158	159·6	559	557	707·1	188	155	189	160	254	143·3	119·6	993	158	163	170
" August	160	200	160	151	157	159.4	567	557	730·6	184	155	168	154	245	144·3	124·1	996	160	160	170
" Sept.	157	201	160	152	156	159·2	577	556	720·8	185	155	163	151	231	144·5	127·2	989	157	160	170
" October	158	200	159	153	155	157	575	572	716·4	187	154	158	148	221	144·	127·7	977	157	158	171
" Nov.	160	197	158	145	154	156·7	569	605	711·7	186	154	160	150	217	144·7	136·5	977	161	158	173
" Dec.	154	194	158	140	153	155·5	565	633	714·8	187	155	157	149	218	143·	154·8	966	164	156	168
1926 January	154	192	164	134	151	154·5	560	634	707·7	186	153	151	150	214	140·7	142·1	950	164	156	168
" February	151	188	163	134	149	150·8	556	636	703·8	183	149	145	148	211	138·7	146·1	938	162	155	168
" March	150	184	164	134	144	148.4	583	632	693·4	183	145	141	145	204	137·5	145·7	923	160	152	171

The point to be borne in mind is that Rs. 10 and Rs. 100 notes are very popular. If these notes are made convertible into gold, there can be no doubt that their popularity will be increased considerably. The most suitable unit, therefore, would be the gold equivalent of Rs. 10.

With the effective establishment of a gold standard, the legal tender limit should be Rs. 50 for the silver rupee. With this limit, it should not be convertible into gold.

The 5-rupee notes should remain as at present with the Controller of Currency, being convertible into silver rupees, the rupee reserve for the purpose being under the Controller of Currency. These will be the rupee certificates that I have suggested.

7. Remittance operations should be entrusted to the Bank.

8. The attempt to introduce elasticity into the currency supply by the device of issuing notes against inland trade bills may be said to have succeeded and a cautious advance developing this useful measure will be advisable.

Hundis, bearing an endorsement by a bank, may be accepted as the basis for such issue.

It is well known that the periodical monetary stringency is due to the demands of the inland trade, especially with reference to the movement of crops. But unfortunately on account of the fact that bills are not the usual instruments by means of which this trade is financed, it has not been possible to arrange the supply of currency to meet the need for it exactly where it arises.

India, however, is not alone in this respect. In South Africa, for instance, recently the scope of operations of the Reserve Bank appears to have been widened, an aim of the Bank being to popularise the bill of exchange as an instrument of credit in the domestic trade in preference to the open account system, the other important object being to provide South Africa with an organised Money Market.

Fortunately in India, *Hundis* as instruments of credit, are familiar in indigenous banking circles, though their popularity would appear to be on the wane. Unless banks in India establish a point of contact with old banking methods, the real banking advance desired by all must be hindered. *Hundis*, after all. are familiar to the Indian mind and banks should show more adaptability by adopting these instruments themselves in the form in which they are familiar. An Indian peasant or sowcar may not understand a cheque or a bill, but he *does* understand a *Hundi*.

An energetic campaign to popularise bills and *Hundis* will be of great value, but the campaign must be led by the Imperial Bank.

There is another direction in which advance is possible and the possibilities of such advance may be explored though an immediate decision may not be feasible. I take it, the Imperial bank will be a bank of Issue. If this is so, it would be useful to enquire whether cash credit accounts cannot be utilised as the basis for issue of additional currency, as appears to have been the Scotch Banking practice with beneficial results to agriculture and industry. This might remove the difficulty of the paucity of bills for the purpose of issue of currency. A *very* cautious advance may be made, the agency of the Co-operative Credit Societies, or co-operative banks being utilised for the purpose. The educative value of such a measure, however small, for fostering the banking habit, may be very great.

9. If India decides for a gold standard, this question will not be urgent. The best rule is to buy silver in the most convenient market whether India or London.