AN OUTLINE
OF
INDIAN CURRENCY

BY

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FOREWORD.

In this small book I have attempted to present a brief and comprehensible account of the Indian Currency Problem, from before the closing of the mints in 1893 to the end of 1926. The aim of the book is to treat the subject, not as a matter of politics, but as what it really is, namely, an interesting and instructive series of experiments in economics, lasting over more than thirty years.

In view of the recent excitement over the Committee's recommendation as to the ratio, a short chapter at the end deals with this point, but it must not be thought that this is the most important side of the question. If it appears at present to overshadow more weighty problems, it is because it affects directly, though temporarily, the pocket of every one in India, from the millionaire to the ryot, and consequently rouses feelings which are not similarly affected by the other recommendations.

It is perhaps a pity that its political aspect has obscured the fundamentally economic nature of the problem, but this at least has the wholesome effect of focussing public attention on an important matter that as a rule attracts all too little attention. And, though some of the arguments used in the heat of controversy will not bear close scrutiny, they do at least tend to the formation of a public opinion which is familiar with the literature of the problem and is keenly interested in some aspects of its practical working.

H. B. T.

April, 1927.

CHAPTER I.

Currency.

Before attempting to deal with the currency and exchange problems that peculiarly affect India, it is as well to devote a few words to the origin and nature of currency as well as to the mechanism of exchange.

Currency may be defined as money in its capacity of a medium of exchange. And money, as a medium of exchange, has a very ancient history which it is of interest to note briefly. At a very early stage in the history of man the difficulties of trade by barter seem to have pressed toward the finding of some form of currency and this was generally discovered in cattle, goats, or sheep, which were not only themselves the most desired form of wealth but were easily transferable from owner to owner within the limits of the same tribe.

But for more extended transactions, their disadvantages must have been very obvious and their use must have led to an infinity of difficulties and disputes.

Gold and Silver.—It was therefore an immense advance when the precious metals—gold and silver—began to come into general use and, displacing cattle and changes of raiment, became the exchange counter of the future.

It is sufficiently remarkable that these two metals, which were first used so many thousands of years ago, form to this day the currencies of every nation in the world.

That it is so is due, not to chance, but to the inherent advantages they possess. It is perhaps as well to note what these advantages are. They consist in the fact that gold and silver are:—

1. Scarce.
2. Prized for ornament owing to their beauty.
3. Not bulky.
4. Practically imperishable—being not subject to rust.

When the precious metals were first used they were dealt in by weight, of which we find continual record in the Bible, of so many talents of gold and shekels of silver. For general use, however, the metal was doubtless worked up into pieces of a convenient size and weight and the next great advance was made when it was realised that it would be useful to have these pieces of uniform weight and to have them stamped by authority to guarantee that the weight was correct.

The authority would naturally be the king and equally naturally his own features would appear on the new medium of exchange, which has now become a coin.

When precious metal was accepted as the best and most enduring medium of exchange it is perhaps unfortunate that the earth should have contained two metals suitable for the purpose. Had only gold, or only silver, been within reach of man, most of the troubles and difficulties of monetary systems from the earliest times right down to the present day would have been avoided.

With one standard of value and one medium of exchange, mankind could hardly have avoided establishing throughout the world currencies easily exchangeable, one with the other. But the choice of two metals has been from the earliest times an apple of discord, for it is only in comparatively recent years that the ascendancy of gold has become beyond dispute. And even now the difficulties arising from the existence of two metals still continue in such an acute form that, here in India, Royal Commission follows Royal Commission, and yet no lasting solution of the problem has been achieved.

It is clear that from early times the existence of two precious metals for exchange purposes called for some regulation. And this regulation took the form of a legally fixed ratio between the exchange value of gold and silver, which presumably would be based to begin with on the market values of the two metals. The earliest records of such fixed ratio are found in the Babylonian era, before the invention of coined money, when gold and silver exchanged by weight on the basis of 1 to 13 1|3, which ratio, Sir David Barbour tells us, continued up to the time of the Persian Empire.

When, however, European civilisation began to emerge from the dark ages, gold coins were not in use. In England, under the early Norman Kings, silver coins were minted but it was not until the 13th Century that gold coins made their appearance, the relative value of the two being apparently promulgated from time to time by Royal decree.

With the discovery of America, the available supplies of both metals increased; so also did the difficulties of the government in attempting to control the relative values, which must have tended constantly to fluctuate with the comparative abundance or scarcity of either metal.

In the 16th Century, Sir Thomas Gresham had enunciated his famous law which is to the effect that *if two coins are in circulation and if one is better than the other, the better coin is driven out of circulation.* As this law is of universal application, as much to-day in India as in England in the reign of Queen Elizabeth, it is important to understand it fully.

At the time of Sir Thomas Gresham the currency was in a very different condition from currency as we know it to-day. Coins that had been clipped, sweated and debased were in constant circulation. Naturally the tendency was for each man to pass on to his neighbour the worst of his coins, the best finding their way into a hoard or into the hands of the bullion dealer. Thus the worse coin tended to drive the better out of circulation.

In the same way, if a ratio of say 15 to 1 were fixed by law as between gold and silver, and if there were heavy arrivals of silver but not of gold, the tendency would be for the gold coin to be worth more than 15 silver coins of a like weight. The gold coin would be the better coin of Gresham's Law, and as the increasing scarcity of gold would raise its value bullion dealers would be prepared to pay more than 15 silver coins for it. But, as the 15 to 1 ratio has been fixed by law, a debtor can legally satisfy his debt by tendering silver coins. Then obviously all debtors will offer silver coins and, if they have gold coins, they will either hoard them or sell them to the bullion dealers. In either case they will have gone out of circulation—*the better coin driven out by the worse.*

The difficulties which confronted the British Governments from the 16th Century onwards will now be understood. It was essential to maintain a definite ratio between gold and silver coins but the ratio so fixed was liable to constant disturbance by the discoveries of new supplies of one metal or the other. As either metal became relatively scarce and valuable it would, by Gresham's law, be driven out of circulation.

The Government were therefore compelled to alter from time to time the relative legal tender value of the two metals which was done by a notification from the Lords Commissioners of the Treasury of the number of shillings to be reckoned per guinea in the payment of taxes and public revenues.

So great, however, were the difficulties of maintaining a bi-metallic Currency that in 1867 the British Government took the momentous step of abolishing the unrestricted coinage of silver, thereby adopting the single gold standard. Silver coins were of course still minted, but only in restricted quantities and as subsidiary coins, whose value bore no relation to their silver content but was fixed in relation to the gold pound sterling.

In a few years practically all the leading nations had followed Britain's example, though in the currency of the Latin Union silver still played a considerable part.

Thus gold became the world's chief standard of value and. what is of greater importance to the question we are now considering, *gold became and still remains the only international medium of exchange.*

We have now to observe how this exchange works as between gold standard nations.

CHAPTER II.

Exchange.

At the present day international trade forms a complex pattern comprising innumerable transactions between all the nations of the world. And each transaction carries with it an obligation on the part of a merchant in the consuming country to pay a merchant in the producing country the value of the goods shipped and received. But while the merchant in the consuming country himself actually signs a cheque in settlement of his debt due to the producer, it does not of course follow that any money will actually be shipped to liquidate the debt, which will, if possible, be set off against debts in the opposite direction or against debts due from a third nation.

The adjustment of Trading Debts.—Thus if Britain ships machinery to India to the value of £10,000 and India ships jute goods to a like value to New York, India's debit is transferred to the U. S. A. And if New York ships that value of railway material to Brazil, the debit is transferred to Brazil who will perhaps pass it on to Paris by the shipment of coffee to France. France may then supply Britain with wines to the amount of £10,000 and the chain is complete. No money has passed from one country to another and although each merchant from his own point of view has either "remitted" money abroad or "received" money from overseas, yet the whole series of transactions has perhaps involved nothing more than a number of book entries between different banks in the City of London and elsewhere.

It is obvious that, while as many as possible of the obligations arising from international trade will thus be adjusted by setting off debits against credits, the result will in fact not be an exact equilibrium. It may leave some nations debtors to a very considerable amount and other nations creditors to a like extent, not necessarily as the result of direct trade between the two, but as the result of the sum of their total foreign trade and commitments. These debts, if more than merely temporary, must be settled in one of two ways; either (a) by a foreign loan or (b) by the payment by the debtor of the international medium of exchange—which as we have seen above is—*gold*. Of course settlement can also be made by the debtor nationals selling foreign securities held by them, but this is equivalent to a loan, being simply the giving up of obligations due from foreigners to them in place of accepting new obligations to foreigners.

Failing a loan or sale of foreign securities the debtor must, as we have said, ship gold. How this comes about in practice, and in what circumstances, are best explained by disregarding for a moment the ramifications of international trade and assuming trade as being carried on exclusively between two nations.

Trade as between two Nations.—For the purpose of our explanation we will assume these nations to be Great Britain and America before the War. Now America, as we know, shipped, and continues to ship, to Britain immense quantities of grain, cotton and raw material and manufactured articles of all kinds. Britain also shipped her manufactures extensively, though on a smaller scale, to America. But whereas almost the only payments due from Britain to America were on account of goods imported, America had to pay Britain various other charges, greatly exceeding items of the same kind payable in the opposite direction.

Putting these charges in detail we strike a rough account between the two nations.

Britain owes to America:

Value of American Exports to Britain.

America owes to Britain:

Value of British Exports to America.

Freight charges due to British ships for carrying American cargo.

Profits to British insurance companies and Banks for services.

Interest on American investments due to British holders.

Expenses of American tourists in Britain.

There will also of course be innumerable other small items to be included on both sides—such as money left by a British testator to a son in America, money sent to "remittance men" and so on. But the principal items are outlined above though it must be remembered that the settlement of any overseas obligation affects the exchange market exactly as do exports and imports of merchandise.

For our purpose therefore it is sufficient to consider each group as "exports" and "imports," the miscellaneous items being usually referred to as invisible exports or imports, because they are not visible in the trade returns, though they have the same effect on the exchanges as do true exports and imports.

Now we have seen that gold is the international medium of exchange. Consequently the parity of exchange between the dollar and the pound will depend on their relative gold content. Par in fact was and is about \$4.8666 = £1 sterling. That is to say the pure gold contained in 48.666 dollars is exactly equivalent to the gold in 10,000 sovereigns, and if the amount due from America to Britain is exactly the same as the amount due from Britain to America then exchange will remain steady at par, because the demand for sovereigns by people holding dollars will be identical with the opposite demand.

If, however, America's claims on Britain exceed her liabilities to Britain, the British demand for dollars will be greater than the American demand for sovereigns, because the British have more dollar debts to pay than sovereign credits to receive.

Therefore possessors of sovereigns will be willing to exchange them for a less number of dollars and cents and the exchange will be said to have moved in favour of America.

It will perhaps make the matter clearer if we imagine a simple transaction in actual merchandise. Let us say that A, a cotton exporter, has sold a quantity of cotton to Liverpool and has drawn a draft for £10,000 on the Liverpool buyer against the shipment. This draft or bill now gives him command of £10,000 payable in England.

Meantime B, who is an Importer in New York, finds it necessary to remit £10,000 to London to pay for goods despatched. If he buys A's draft that will meet the case and he will be prepared to pay the par value $48,666, less some allowance for interest since he is paying cash and the draft will not be met till the mail containing it reaches Liverpool.

But if B on entering the market to buy £10,000 finds not only A's draft offered him but also similar drafts from C, a wheat shipper, and D, an oil exporter, and if we imagine that there are no further transactions than these, then what will happen?

A, C & D have each a bill for £10,000 to sell. But there is only one buyer, B. Then A, C & D will compete against one another by offering B their £10,000 bill for less than $48,666.

Suppose A finally succeeds in selling his bill to B, (in practice of course both A & B would be dealing with a Bank, though the essence of the transaction would be as above, viz., A the seller and B the buyer) then C & D who are in need of dollars at once, have sterling drafts to sell for which there is no demand.

But though there is no immediate demand for remittances to London it may be that the bankers in New York anticipate that there will be heavy remittances in the course of a month or two.

Then if they can buy C & D's bills for below par it may pay them to give cash to C & D for the bills and to lend out the proceeds of the bills in London. Later if the expected demand for remittances matures they can sell the sterling proceeds of the bills to another American importer for more dollars than they had to pay C & D and so recoup themselves for any loss of interest incurred.

Consequently if the dearth of remittance demand to pay for imports (or the dearth of the supply of bills against exports) is merely seasonal and temporary the exchange will only move by the amount which appears sufficient to pay the bankers for the necessary temporary finance.

But suppose it is more than temporary. Suppose, with C & D's bills offering for sale, there are not only no remitters wanting to buy but no likelihood of any remitter coming on to the market in the near future, then what will happen? Then an exchange banker will offer perhaps $4.83 odd per £1 for the bills and if C & D accept, he will send the bill to London, encash it, take the proceeds in gold and ship the gold to New York, where it is instantly exchangeable into dollars.

In doing this he will allow for the cost of shipping, freight and insurance besides loss of interest during the period of transit. The loss of interest depends on the ruling rate but the whole expense of shipment and interest together are remarkably small and probably in pre-war days did not exceed 2 or 3 cents per pound sterling.

It is therefore clear that, however many bills C & D and others have to offer and however keenly they have to compete to find buyers, still they can never be compelled to accept materially less than par minus transit charges and interest, because if they cannot get that much it will pay them to send their drafts across the Atlantic for encashment, and themselves bring in the proceeds in gold. And of course in practice the competition of bullion dealers and banks makes it unnecessary for the merchant ever to do this for himself. So, if we assume the charge to have been about $3\frac{1}{2}$ cents per pound, then dollar exchange, so long as Britain maintained a gold standard, could never go below $4.83.

Similarly if the imaginary transactions outlined above had been reversed and there had been an excess of remitters in New York over drawers—or, what comes to the same thing, an excess of London drawers on New York over London remitters to New York—then exactly the same results would have occurred. Competition would have compelled London exporters to offer for £1 cash $4.90 owing to them in New York—but they would not offer more as they would rather buy gold in New York and bring it to London for sale. Therefore exchange between Britain and U. S. A., as we see, is limited, above and below par, by the cost of sending specie from one country to the other. This limit is known as *specie point.*

We may now set out in general terms the important result that follows.

Limits of Exchange Fluctuations.— *Between countries maintaining a gold standard, exchange can never fluctuate in either direction by more than the cost of shipping bullion.*

It will be obvious that if, instead of the above transactions, we assume similar dealings between, say, France and Britain to-day, there is no limit to the exchange fluctuations because, as France is not on a gold standard, the possession of a claim to French francs does not give any power to obtain gold.

But, it may be asked, how long can this drain of bullion go on and what stops it going on indefinitely? In actual practice, gold may flow from Britain to the

U. S. A. but will meantime be flowing into Britain from Africa and, temporarily, from the continent. But let us keep to our assumption of trade, between two nations only.

Effect of Bank Rate.—Suppose there be a continual excess of American exports to Britain over British exports to America. Then as we have seen specie flows from Britain to pay for the excess. Now the continual flow will make money plentiful in New York and scarce in London, because gold is the base not only of all currency but of all credit transactions. So that with the base reduced, credit in London must be restricted while in New York credit will expand. In ordinary parlance money will be "tight" in London and "easy" in New York and consequently the use of money will be more expensive in London than in New York. Moreover this tendency will be in line with the desire of the Bank of England to check the outflow of gold and the result will be that the Bank rate, which is the rate at which the Bank of England will discount first class bills, will be raised. It will then stand, let us say, at 5 per cent. against 4 per cent. in New York.

Now we have seen that an American Banker bought the export bills of C & D and sent them to London for encashment with a view to shipping the gold to New York. But now that the Bank rate is 1 per cent. higher in London than in New York why should he ship the gold at all? He will prefer to leave it in London to obtain the higher yield available there and thus the rise in the Bank rate will have had its desired effect of keeping gold in London and thus protecting the Bank of England's gold reserve.

In addition to this, the fact of money being plentiful and cheap in America will be reflected in a rise in the price of goods, while the existence of dear money in London will tend towards a fall in goods prices in Great Britain.

These high prices in America will operate as a check on her exports to Britain while low prices in Britain will encourage her exports to America where goods prices are high. This will in time tend to reduce or even reverse the balance of indebtedness between Britain and America and with it the flow of gold bullion.

The Gold Standard in Britain.—In concluding this chapter it is as well to emphasise that the transactions assumed above are as between two gold standard countries. Great Britain which was the pioneer of the single gold standard was compelled to abandon it during and after the War, when, the automatic check of specie point being removed, sterling went to a heavy discount in New York. But she has since reverted to the gold standard, a course that led to a considerable volume of criticism at the time.

But, it may be asked, how can Britain at the present time be said to have a Gold Standard? There is not a sovereign to be seen there, nothing but Bank Notes, Bradburies, Silver and Copper, and how can notes, silver and copper be described as a gold standard?

The answer to this is that a gold standard is one thing and a gold currency another.

To maintain the exchange value of currency there must be available a quantity of gold to be shipped abroad to those countries who have claims payable to them. Therefore gold is essential for external use. But for internal circulation any currency is satisfactory provided it has the confidence of the people.

Now before the War in Great Britain a considerable amount of gold was in circulation and therefore, if suddenly needed to support exchange, it was to a large extent not available. The position of the currency was therefore weaker than it would have been if the gold had been held in a central reserve as it is to-day. Also the use of so much gold merely for passing from hand to hand was wasteful and expensive.

All gold therefore is now held in reserve and notes are issued for currency, the statement that Britain has "reverted to the gold standard" meaning simply what is necessary to the situation, viz., that to anyone tendering British Currency, gold is always available, subject only to a minimum of quantity.

CHAPTER III.

Indian Currency up to 1913.

The object of the first two chapters is to enable us to start the consideration of the Indian Currency System with two definite statements which are of the highest importance to any understanding of the problem.

These are:—

(1) That gold is the sole international medium of exchange, and

(2) that between gold standard nations, exchange will remain stabilised within narrow limits.

Consequently any nation wishing to maintain a stable exchange with leading foreign states must have what we may describe as an external gold standard and, if its internal standard is not gold, it must have the means of converting its internal currency into gold for the purpose of its foreign trade obligations.

While however we have so far laid stress on what we may call the external aspect of currency, we must not overlook the fact that the first requisite of any currency is that it shall be current. That is to say that it shall pass readily from hand to hand and be freely accepted to an unlimited extent in payment of goods. And, in India, the only coin that as yet fills these requirements is the silver rupee, the note being only acceptable because confidence has now been established that it will at any moment be cashed in rupees without possibility of doubt.

The Indian Currency Problem.—This, then, in a word has constituted the problem of Indian Currency, viz. :—

While maintaining a silver rupee currency in India, to provide for the conversion of rupees into gold for the purposes of foreign trade at a stable rate of exchange.

We will now deal with the events that led up to the stabilisation of the rupee at 1s. 4d., which rate was successfully maintained until the War and the short supply of silver from Mexico (due to internal disturbances) raised the silver content value of the rupee above its exchange value.

It was by an Act of 1835 that the rupee was formally established as the standard coin of the whole of British India but, though gold thereby ceased to be legal tender, the coining of 15-rupee gold mohurs was authorised as also was their receipt at the treasuries at their full value. As the gold mohur and rupee were of identical weight this fixed the exchange ratio of the two metals at 15 to 1 which, it is to be noted, is not very far from the 13 1|3 to 1 ratio of the Babylonian era, referred to above.

But once more the laws of supply and demand proved too strong for any fixed and artificial ratio. The extensive discoveries of gold in Australia made gold relatively plentiful and resulted in the gold mohur having a market price of considerably below 15 silver rupees. "This," remarked the Directors of the East India Company in 1852, "has been and is likely to be still more embarrassing to the Government of India .... as holders of gold coin have naturally availed themselves of obtaining at the Government

Treasuries a larger price than they could get in the market." Consequently it was declared by Notification (Dec. 25th, 1852) that, on and after 1st January 1853, gold coins would no longer be received in any public treasury within the territories of the East India Company.

Sovereigns accepted at Treasuries.—In 1864, however (on the initiative of the various commercial bodies in India), a second attempt was made to introduce gold as legal tender, this time in the form of sovereigns and half sovereigns, but the proposal was not accepted by the Imperial Government. They did however agree as an experimental measure to accept sovereigns and half sovereigns at Government Treasuries at the equivalent of 10 rupees and 5 rupees respectively, a notification to this effect being issued on Nov. 23rd, 1864.

It is interesting to note that, in sanctioning this arrangement, the Imperial Government considered that it would "pave the way for the use of a gold coinage in whatever shape it may ultimately be found advisable to introduce it."

Subsequently on Oct. 28th, 1868, the Government of India raised the rates to Rs. 10¼ and Rs. 5⅛ respectively but circumstances soon rendered the notification a dead letter.

We now reach a state of affairs exactly the opposite of that which existed in 1852. The increase in the output of gold slackened, that of silver advanced. Moreover, as we have seen above, from 1867 onwards first Britain and then most of the other leading Nations had abandoned the free coinage of silver and based their currency systems on the single gold standard.

Fall of Silver.—This led to an increased and progressive demand for gold and a slackening in the demand for silver. Looked at from the gold currency point of view silver had fallen, from the silver point of view, gold had risen.*

Now, most of the leading nations being on a gold standard, trade between them was unaffected but with India the case was different.

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* Looked at from a "neutral" standpoint, viz., the general level of prices, both the above movements took place. Gold rose *and* silver fell. The following index figures quoted in Mr. H. F. Howard's "India and the Gold Standard," show this clearly. The silver prices are Mr. Aitkinson's, the gold, Mr. Sauerbeck's.

Year.	Silver Prices.	Gold Prices.
1873	100	100
1874	108	92
1875	97	86
1876	100	86
1877	129	85
1878	139	73
1879	127	75
1880	109	79
1881	99	77
1882	98	76
1883	99	74
1884	107	68
1885	106	65
1886	103	62
1887	104	61
1888	111	63
1889	118	65
1890	118	65
1891	120	65
1892	132	61
1893	129	61

India had a free silver currency, that is to say anyone could tender silver to the Mints and obtain rupees in exchange. Consequently the value of the Rupee was linked to that of silver so that every drop in the gold price of silver meant a drop in the exchange value of the rupee. The arrangement whereby the sovereign was received at the Treasuries as the equivalent of 10 rupees constituted a high limit to the rupee, which could not rise materially above 1|10th of a sovereign = 2 shillings.

But there was nothing to fix a low limit and consequently as silver fell, so too fell the Indian Exchange. The extent of the fall is shown as follows:—

Year	Pence
1872-3	22.75
1873-4	22.35
1874-5	22.15
1875-6	21.62
1876-7	20.50
1877-8	20.79
1878-9	19.79
1879-80	19.96
1880-81	19.95
1881-82	19.89
1882-83	19.52
1883-84	19.53
1884-85	19.30
1885-86	18.25
1886-87	17.44
1887-88	16.89
1888-89	16.37
1889-90	16.56

Year	Pence
1890-91	18.08
1891-92	16.73
1892-93	14.98
1893-94	14.54

It will be readily believed that this continual dwindling of the rupee was causing acute difficulties to trade and on Feb. 18th, 1892, we find the Bengal Chamber of Commerce complaining that it was "impossible for men of business to feel any confidence in the future value of the rupee" and urging that, failing an International agreement for the regulation of a fixed ratio between gold and silver, the Government of India should consider the advisability of introducing a gold standard. At that time the advocates of bi-metallism were attempting to bring about such an arrangement and an International conference was held at Brussels to this end but broke up without reaching any agreement.

Meantime on June 1st, 1892, the Government of India advocated the closing of the mints to the free coinage of silver, to prevent the continual fall of the rupee by restricting the issue and the declaration of sovereigns as legal tender on the basis of 1s. 6d., to prevent the rupee rising materially above this figure.

The Herschell Committee, 1892-93.—The matter was referred to a Committee under the chairmanship of Lord Herschell which reported in favour of the closing of the mints to the free coinage of silver and advocated the adoption of a gold standard. In their own words. "The closing of the mints against the free coinage of silver should be accompanied by an announcement that.

though closed to the public, they will be used by Government for the coinage of rupees in exchange for gold at a ratio to be then fixed, say 1s. 4d. per rupee, and that at the Government Treasuries gold will be received in satisfaction of public dues at the same ratio."

The Committee's recommendations having been approved by the Imperial and Indian Governments, there was passed, on June 26th, 1893, the Act, No. VIII of 1893, "to amend the Indian Coinage Act, 1870, and the Indian Paper Currency Act, 1882." This Act provided for the closing of the Indian Mints to the "free coinage" of both gold and silver—Government retaining the power to coin silver rupees on its own account. By Notifications of June 26th, 1893, arrangements were made (*i*) for the receipt of gold at the Indian Mints in exchange for rupees at a rate of 16d. per rupee, (*ii*) for the receipt of sovereigns and half-sovereigns in payment of sums due to Government at the rate of Rs. 15 for a sovereign, and (*iii*) for the issue of Currency Notes to the Comptroller-General in exchange either for British gold at the above rates or for gold bullion at a corresponding rate.

The closing of the mints to the free coinage of silver did not of course have any immediate effect on Exchange. The shortage of rupees could not possibly make itself felt for some time and meanwhile an outside cause militated against any attempt to uphold Exchange. The United States Government were, under the Sherman Act, purchasing 4,500,000 ounces of silver monthly, which had a considerable effect in keeping up the value of the metal. In November 1893 this Act was repealed and purchases ceased. The result of this repeal was greatly to increase the available supply of silver, while removing a large and constant demand. This led to a further sharp fall in the gold price of silver which averaged $28\frac{15}{16}$d. in 1894-95 as against $35\frac{5}{16}$d. in 1893-94, $39\frac{3}{16}$d. in 1892-93 and $45\frac{1}{16}$d. in 1891-92. Consequently the fall in exchange continued steadily through 1894, until, on January 25th, 1895, Council bills were sold at s. $0\frac{31}{32}$d Fortunately this proved to be the lowest point, and the unbroken decline, which had extended over a period of 22 years, at last began to give place to a steady and continuous rise. Just three years after the corner had been turned—namely in January 1898—the rate of 1s. 4d. was regained.

While the recommendations of the Herschell Commission did not extend beyond the closing of the mints and the acceptance by Government of gold in exchange for rupees it was never intended or expected that this would prove a final solution of the problem. On the contrary it was only the first step in the direction of establishing gold as the standard of value in India. Obviously the position attained in 1898 could not be considered satisfactory as a permanent basis of settlement and accordingly, as soon as exchange had reached 1s. 4d., their Despatch being dated March 3rd, 1898, the Government of India forwarded to the Secretary of State certain proposals, involving a loss in selling rupees at their bullion value.

Fowler Committee, 1898-99.—These proposals were referred to a Royal Commission under the Chairmanship of Sir Henry Fowler.

The Committee's sittings extended over a year, during which period a marked improvement took place in the situation. Exchange remained steady at 1s. 4d. in spite of abnormally heavy drawings by the Secretary of State, and a sum of £2,370,000 in gold had been brought in to the Indian Treasury.

This position of affairs naturally influenced the Committee against the Government of India's proposals which had been framed earlier under less happy conditions. The proposals were therefore rejected and the following recommendations were made by the Committee:—

"We are in favour of making the British sovereign a legal tender and a current coin in India. We also consider that, at the same time, the Indian mints should be thrown open to the unrestricted coinage of gold on terms and conditions such as govern the three Australian branches of the Royal Mint. The result would be that, under identical conditions, the sovereign would be coined and would circulate both at Home and in India."

"We also recommend that any profit on the coinage of rupees should not be credited to revenue or held as a portion of the ordinary balance of the Government of India, but should be kept in gold as a special reserve, entirely apart from the Paper Currency reserve and the Ordinary Treasury balances."

With regard to the rate at which the sovereign and rupee were to exchange the Committee were not unanimous, but the majority favoured the retention of the rate of 1s. 4d. which was accordingly embodied in the recommendations. A minority report of two members in favour of a basis of 1s. 3d. was, with other minority reports, appended to the findings of the Committee. The recommendation that the sovereign should be made legal tender was given effect to on 15th September 1899, half sovereigns being also included. The suggestion for the establishment of a Gold Standard Reserve, to be built up from the profits on the coinage of rupees, was also accepted and such profits were credited to a Gold Standard Reserve Fund from 1st April 1900.

Gold Exchange Standard attained.—The joint result of the Herschell and Fowler reports was the establishment of an Indian Currency System on a Gold Exchange basis. That is to say, while retaining an internal silver circulation, arrangements had been made for meeting external requirements by the exchange of rupees for gold on a fixed basis and, though without legal obligation to do so, gold for rupees.

It is necessary to understand just how the system worked. That the rupee could not rise materially above 1s. 4d. needs no further proof. The fact that sovereigns were unlimited legal tender for 15 rupees was sufficient to produce this result.

To prevent a fall below 1s. 4d. was however a more difficult matter. But this result was secured, so far as it was secured, by a combination of a restricted currency with the so-called favourable balance of trade, i.e., an excess of exports over imports.

During the 13 years following the report of the Fowler Committee the excess of Exports of Merchandise over Imports of Merchandise was as follows:—

	In £ Millions
1899-00	23
1900-1	18

	In £ Millions
1901-2	24
1902-3	29
1903-4	41
1904-5	36
1905-6	33
1906-7	40
1907-8	27
1908-9	16
1909-10	43
1910-11	51
1911-12	56

Assuming the amount payable in England by the Government of India on account of Home Charges to have been £18,000,000 annually it will be seen that there remained, almost every year, a substantial amount due to India on balance. In other words there were almost always foreigners, who could command gold, anxious to exchange their gold for rupees to meet their debts to Indian exporters.

The natural effect of this was to maintain the gold value of the rupee as, silver coinage being no longer open to the public, it was useless for the foreign debtors to send silver, as silver could not be changed into rupees—it could only be sold for its bullion value. The tendency therefore was for exchange to remain mostly between 1s. 4d. and specie point, say 1s. 4⅛d. and for gold to flow into India to meet the balance of trade.

Gold did in fact pour into India, the imports for several years prior to 1913 averaging nearly £20,000,000 per annum, partly in sovereigns and partly in bullion.

It has now been shown that by the operation of a favourable Balance of Trade the rupee was in a normal year, safely established at 1s. 4d. But some safeguards were necessary to meet abnormal seasons and these were found in the Paper Currency Reserve and the Gold Standard Reserve.

Gold Reserves.—The Paper Currency was instituted in 1862 and, following the Bank Charter Act of 1844 which governs the issue of Bank of England notes, it was provided that there should be a metallic reserve against the whole of the notes issued except to an extent of 4 crores which could be issued against Government Securities. This issue against securities had been increased up to 1913, to 14 crores and the Paper Currency Reserve as on 31st March 1913, against a gross circulation of 68.97 crores was as follows:—

	Crores
Rupees	16.45
Gold	38.52
Securities in London ..	4.00
Securities in India ..	10.00
	68.97

It will be seen that the maximum amount which can be invested in securities has been so invested and that 4 crores are in London securities, i.e., securities saleable for gold. Adding this amount to the gold metallic reserve (held partly in London and partly in India) we have total gold resources of Rs. 42.52 crores in the Paper Currency Reserve.

The Gold Standard Reserve, which was adopted on the recommendation of the Fowler Committee, was inaugurated in 1900 as the Gold Reserve Fund. It was a reserve accumulated from the Mint profits and especially intended to maintain the gold exchange value of the rupee. Originally the fund was held entirely in gold and gold securities but in 1906 there was a severe shortage of rupees which both the mints and the Paper Currency Reserve proved barely adequate to relieve. It was therefore decided to hold up to Rs. 6 crores in rupees and the name of the fund was altered to the Gold Standard Reserve Fund.

(Another departure from the Fowler Committee's recommendations was the utilisation in 1907 of one half of the mint profits for Capital expenditure on Railway construction. A sum of £1,123,000 was so credited—at the expense of the Gold Standard Reserve Fund—but events which followed led to the prompt reversal of this new policy.)

The Gold Standard Reserve Fund as on 31st March 1913 was as follows:—

		£
Sterling:—	Long dated securities	4,956,165
	Short dated securities	10,989,504
	Sums lent at short notice	1,005,664
	Total Invested	£16,951,333
	Gold	1,620,000
	Silver Rs. 6 crores	4,000,000
		£22,571,333

We thus see that as on 31st March 1913 the Government of India could dispose of gold and gold securities to the following amount.

Paper Currency Rs. 42.52 crores =	say	£28,346,000
Gold Standard Reserve ..	..	£18,571,333
	Total	£46,917,333

In addition the Secretary of State has always certain Cash Balances in London and the balance so held on 31st March 1913 was £8,783,970. Adding this to the amount of the gold reserves we have a total of £55,700,000 gold resources at the disposal of the Government of India.

Now, India, as we have seen, has normally a favourable balance of trade. Should there however come a period of adverse trade conditions, such as may always occur in the event of a failure of the monsoon, the sterling resources of Government are available to meet the foreign commitments of Indian trade and to prevent the exchange falling materially below par. They act as a fund from which importers may, in exchange for rupees tendered in India, obtain gold already available in London, with which to meet their overseas trade commitments. Therefore, so long as these resources are adequate, exchange cannot fall below a point fixed by Government and this point is roughly speaking par, less what it would have cost the importer to ship gold to London. In other words specie point. So that, as we see, India has now arrived at the same position as a Gold Standard Nation, i.e., so long as the system works, her currency can only fluctuate between specie points. She is therefore on a Gold Exchange Standard.

The manner in which Government will fix the low exchange point is by the offer of what are known as Reverse Councils, the nature of which it is as well to explain at this point. It has been seen above that the Government of India are under the necessity of remitting annually to the Secretary of State sufficient to cover their Home Charges, which in 1913 amounted roughly to £18,000,000. This remittance is effected by the Secretary of State in Council selling Drafts or Bills on the Government of India, payable in the Presidency Towns. These bills are called Council Bills or more shortly, "Councils" and they are sales by the Secretary of State of rupees in India in exchange for sterling in London. Now when, in a time of weak exchange, Government come in to support the market they sell bills which are exactly the reverse of the above, that is to say they sell sterling in London in exchange for rupees in India. The bills thus sold are accordingly known as "Reverse Councils."

The machinery, therefore, in a year of weak exchange, would be firstly that the Secretary of State would cease selling Councils and would use his sterling resources for his immediate requirements and secondly that the Government of India would sell Reverse Councils to an unlimited extent, until the crisis was ended by the resumption of more normal trade conditions. During the great crisis of 1907-8 the gold resources of Government were depleted to the extent of about £25,000,000 before more normal conditions relieved the pressure.

The result of a crisis of this kind will of course be not only to deplete gold resources but correspondingly to increase the stock of rupees, which are received in payment of Reverse Councils and are thus temporarily withdrawn from circulation. When the crisis is over, there will once more be a demand for rupees which Government will meet out of their stock, while the gold obtained in exchange will go back into the reserves, thus restoring the gold resources depleted by the crisis. The existence of both metals in the Paper Currency Reserve is thus seen to be of great importance to Indian Finance, providing as it does a measure of elasticity which would otherwise be totally absent.

Without the Paper Currency the burden of maintaining exchange would have been enormously greater and almost prohibitively expensive.

CHAPTER IV.

The Chamberlain Commission—1913.

Gold Exchange Standard attained.—It will be seen from the previous chapter that in 1913 India had reached a Gold Exchange Standard and that progress in this direction had been gradual and tentative. The system, as it worked in practice, though framed on the reports of various currency commissions, had in fact diverged from the track mapped out and had developed empirically in a different direction.

Thus the Fowler Commission had looked to the establishment of a Gold Standard, visibly expressed in a gold currency. But the experience of intervening years had impressed upon officials the indisputable fact that stability of the rupee depended, not so much on the existence of a quantity of gold in the hands of the public, as on the existence of a centralised gold reserve which should be freely available to support the rupee. That, in fact, what was needed to maintain stability was a standing undertaking by Government to sell, in exchange for rupees, gold in London at exchange no higher than the expense and loss of interest involved in shipping gold from India.

In other words a standing open offer of Reverse Councils at about 1s. $3\frac{29}{32}$d.

During the principal crisis that had been faced, that of 1907-08, the Government did indeed after a period of hesitation, sell Reverse Councils freely and thus maintain stability. And in 1913 the commercial community certainly believed that, in a similar crisis, Reverse Councils would again be offered to an unlimited extent. There was however no definite undertaking by Government to do so, nor was there any specific admission that a standing offer of Reverse Councils was the corner stone of the Gold Exchange Standard.

Similarly, though no gold mint was established in India, the policy of minting sovereigns in Bombay had never been abandoned. It had in fact been the subject of correspondence between the Secretary of State and the Government of India at various times, while later, in 1912, the desirability of coining gold 10-rupee pieces was discussed.

Further the gradual growth of the system had led to a lack of defined policy in regard to the location of cash balances and reserves and the sale of council bills.

It was in fact freely asserted that, by selling Councils in excess of his requirements for Home Charges, the Secretary of State was arbitrarily increasing the volume of circulation in India. This however, was not the case. The Secretary of State could only sell councils in response to a demand for rupees. The effect of such sales was that rupees were issued to the public in India against gold held in London and utilised, partly as a reserve to support exchange and partly to buy silver to replace the rupees so issued.

For whichever purpose the gold was needed it would be needed in London, not in India.

Had the Secretary of State refused to sell Councils, the Banks would have been compelled to ship gold to India where it would have been tendered to Government for rupees, so that the volume of currency in circulation would have been the same and the gold which had been brought out would probably have had to have been shipped back again later.

The system was however in need of review, so that the lessons of experience could be examined and some definite policy laid down for future guidance.

The Royal Commission.—Accordingly on 17th April 1913 a new Royal Commission was appointed under the Chairmanship of Mr. Austen Chamberlain, now Sir Austen Chamberlain, K. G. The Commission was a strong one and included amongst others Sir Robert Chalmers, Permanent Secretary to the Treasury, Sir Ernest Cable (now Lord Cable) head of one of the great Calcutta Mercantile houses, Sir Shapurji Broacha, the well-known Bombay financier and Mr. J. M. Keynes, Fellow of Kings College, Cambridge and Lecturer in Economics.

Mr. Keynes had not at that time the world-wide reputation that he enjoys to-day. He was, none the less, probably the leading authority on Indian Currency and his "Indian Currency and Finance," which he was completing when appointed to the Royal Commission, remains the classic work on Indian exchange before the War. His hand is plainly discernible in the masterly report which was issued by the Commission on February 24th, 1914.

The report was signed by all the Commissioners, subject only to a note of dissent on certain points by Sir James Begbie.

The principal Secretary to the Commission was Mr. Blackett then of the Treasury now, as Sir Basil Blackett, one of the most successful Finance Members that has served India.

The recommendations of the Commission were on the whole favourable to the system which had grown up under pressure of experience. But a few improvements were suggested and an attempt was made to lay down certain broad principles which should govern the future development of the Gold Exchange Standard.

The following are the most important clauses in the Summary of Conclusions with which the report terminates:—

"(iv). The time has now arrived for a reconsideration of the ultimate goal of the Indian Currency system. The belief of the Committee of 1898 was that a Gold Currency in active circulation is an essential condition of the maintenance of the Gold Standard in India, but the history of the last 15 years shows that the Gold Standard has been firmly secured without this condition.

"(v) It would not be to India's advantage to encourage an increased use of gold in the internal circulation.

"(vi) The people of India neither desire nor need any considerable amount of gold for circulation as currency, and the currency most generally suitable for the internal needs of India consists of rupees and notes."

The Gold Question.—The question of the desirability or otherwise of a gold circulation was and is so important a point in the polemics of Indian Currency that the matter was dealt with at some length by the Commission. Their masterly analysis remains as true to-day as when it was written, and is therefore given here in extenso:—

"Is it then desirable that the Government of India should urge or encourage the circulation of the sovereign? The chief arguments which have been adduced in favour of such action appear to be as follows:—

(i) That gold is a more convenient and portable medium of circulation than the rupee.

(ii) That a gold currency is a necessary step towards what may be regarded as the ideal currency, viz., paper backed by gold in reserve.

(iii) That some prestige attaches to the possession of a gold currency, whereas a silver circulation is the mark of less progressive peoples.

(iv) That a large amount of gold in circulation is a strong, and, in the view of some people, the only adequate support for exchange.

(v) That the constant mintage of fresh supplies of rupees is objectionable, and would be obviated by an increasing circulation of sovereigns.

(vi) That until India has a gold currency in active circulation, India will continue to possess an artificial and managed currency.

(vii) That India should be encouraged to absorb gold in order to protect the world in general from a further rise of prices due to the greatly increased production of gold.

"The first argument is valid only in so far as concerns large payments which for any reason cannot be discharged in notes; but India must continue for many years to use rupees for payment of the small amounts which form the bulk of internal transactions.

"On the second argument we would say that history gives no support to the view that a paper currency can only be reached after a gold currency has been in circulation. A paper currency, if readily encashable, is the most economical medium of circulation, and at the same time provides a readily available reserve of gold for foreign remittances.

"The argument that some prestige attaches to the possession of a gold currency is chiefly due, we think, to a confusion between a gold standard, which has undoubtedly become in the last forty years the mark of a progressive people, and a gold currency, in the sense of a preponderating use of gold for the purpose of effecting internal exchanges. So far as the internal circulation is concerned, a widespread use of cheques is generally agreed to be the most progressive system. After this comes the use of notes, which compose by far the greater part of the currency of most European countries. The preponderating use of gold coin is not characteristic of a single one of the Great Powers of the world, and it may be said that the only country which really conforms to this ideal is Egypt, where the continual inflow and outflow of sovereigns is an economic loss to Egypt herself and a cause of recurrent inconvenience to the money market of the world.

"The fourth argument, that the encouragement of a gold circulation is calculated in the long run to strengthen exchange, is probably that which carries most weight, and has been supported before us, in one form or another, by several witnesses who were in a position to speak with some authority. It requires, therefore, careful consideration.

"In the first place, some witnesses seemed to imply that, if gold were to be used in India to the same extent that it is, say, in the United Kingdom or in Germany, the exchange problem would have been largely simplified. We think that this view is mistaken. The ability of these countries to meet at all times their immediate foreign indebtedness depends on the central reserves of the banks of these countries, on the influence exerted by these banks on the other constituents of the money market, and on their bank rate policy. It is not possible to point to any occasion in contemporary history on which sovereigns in the pockets of the people have proved a resource on which to count for easing the situation when a monetary crisis threatens the Bank of England's gold reserve. So little are the authorities of the Reichsbank impressed by the value of gold in active circulation for the purpose of settling international indebtedness, that they have been lately engaged in an active policy of replacing some part of this gold by notes of smaller denominations than were formerly current, whilst the gold itself has been used to strengthen the central reserve. It is useless to suppose that the advantages of the existing monetary system of the United Kingdom can be obtained for India by imitating what is, perhaps, the least vital part of this system, namely, the use of sovereigns for that small class of payments which are made in actual cash, while ignoring the nature of the complex banking and financial system upon which the stability of exchange really rests.

"In the second place, it is important that advocates of a gold currency should be clear as to the scale on which they think it would be feasible and wise to introduce such a currency in the near future. If it is their active circulation to the same extent that it is used, for desire and their intention that gold should be used in example, in Egypt, then no doubt gold from circulation would be available for export in considerable quantities at times of depressed trade. For, in that country a large part, measured in value, of the total transactions, instead of a very small percentage, as is the case both in the United Kingdom and in India, is carried out with gold, so that a contraction in the amount of business is likely to release a nearly proportionate amount of gold for export. In order to attain, however, to this state of affairs in India, or even to approximate to it, it would be necessary to reduce the note issue to a comparatively insignificant position, and to withdraw from circulation, at large expense, no inconsiderable part of the existing circulation of rupees. If, however, the advocates of a gold currency contemplate only such an addition of gold to the currency as can be made through the gradual increase of the aggregate circulation, without detriment to the existing circulation of notes or withdrawal of rupees now circulating, gold must continue to occupy for a good many years to come no more than a subsidiary position in the currency system. We do not believe that exchange would materially benefit from the circulation of gold on this scale. There would still be so many rupees in circulation that a considerable quantity could be spared at times of depressed trade, and it would be rupees which, as at present, would flow back into the hands of the Government at such times. All experience goes to show that, so long as the public have the option of making payments in tokens or in gold, it is the surplus tokens and not the gold in circulation which will seek an outlet at a time of weak exchange; and this will continue until the supply of tokens has been so far contracted that they are no more than sufficient for the ordinary business in the transaction of which coins of a low denomination are alone convenient. Thus it is a mistake to believe that to have 10 or 20 per cent. of the total active circulation in the form of gold means 10 or 20 per cent. of the advantages, such as they are, of having nothing but gold in circulation. During the crisis of 1907-8, while £4,179,000 in gold was withdrawn by the public from the Paper Currency Reserve, only £250,000 was exported on private account. We do not believe, therefore, that the circulation of gold on a moderate scale only would materially reduce the liabilities which Government ought to be prepared to meet.

"In the third place, it is of great importance to consider from what source any gold which may find its way into circulation is likely to come. If the gold merely takes the place, not of notes or of rupees now circulating, but of new rupees which it would be necessary otherwise to mint, the effect is to diminish the strength of the Gold Standard Reserve by the amount of the profit which would have been made from the new coinage. This would bring to an end the natural growth of the Gold Standard Reserve (except in so far as its present funds might be invested and earn interest), and it is very improbable that so moderate a public circulation of gold as could possibly be obtained in this way would be as valuable in supporting exchange as gold, even though of a less aggregate quantity, in the Gold Standard Reserve. But it has to be remembered that India's demand for additional currency has been exceedingly irregular; and it would be rash to base currency policy on the assumption that this demand will be large, on the average, over the period of years immediately in front of us. For if, on account of a falling off in the demand for additional currency or for any other cause, such as a greater success in the popularisation of gold than most of its advocates now anticipate, gold in circulation were to take the place of notes or of rupees now circulating, the necessary and immediate consequence of this must be a rapid depletion of the gold now held by Government in the Paper Currency Reserve. Now it must be conceded, and has in fact been acknowledged by most of the witnesses who have pressed for a gold currency, that, sovereign for sovereign, gold in circulation is less effective than gold in reserve for supporting exchange. The depletion, therefore, of the gold in the Paper Currency Reserve, which now serves as a substantial aid to the Gold Standard Reserve in the support of exchange, might gravely weaken the Government's position at a time of exchange difficulties; and the policy of popularising gold, so far from helping exchange, would have jeopardised it. Advocates of a gold currency are met, therefore, by the difficulty that the circulation of gold on a moderate scale only is of no substantial use while, on the other hand, the circulation of gold on a large scale, at any time in the near future, must necessarily be at the expense of the existing Reserves and, so far from increasing the gold in the country, must have the effect of making what gold there is less available for the support of exchange. Advocates of this policy have also to remember that every step in the direction of popularising gold makes it more likely that people will cling to the gold they have and seek to obtain what additional gold they can, on any occasion of crisis or general want of confidence.

"The argument that the coinage of fresh rupees is objectionable and ought to be avoided is largely bound up with the argument just examined; for the possible danger to exchange of a very large circulation of tokens is the main ground of the objection. But this is a convenient place at which to point out that it is by no means certain that an increase of gold in circulation will be altogether at the expense of rupees. In many respects gold is a far more formidable rival to the note issue than to rupees, since for many purposes a coin of so high a value as the sovereign cannot possibly take the place of rupees, whilst experience elsewhere has shown that a public preference for gold, or alternatively for notes, is largely a matter of habit and custom. To habituate a people, therefore, to the use of sovereigns is almost certain in the long run to militate against the use of notes, even though at first the sovereign is able in some cases to obtain a vogue where, at present and immediately, this is not possible for notes.

"There remains the argument that without gold in active circulation India's currency system must remain a 'managed' system, it being implied that a managed system is a bad system. The ideal with which this managed system is contrasted seems to be the system of the United Kingdom where fresh supplies of the only unlimited legal tender coins, the sovereign or the half sovereign, can be obtained at will by any one who takes gold to the mint for coinage.

"In our opinion this contrast is of no value. There does not appear to us to be any essential difference between the power to import sovereigns at will and the power to have gold coined into sovereigns in India. The only point of the criticism that India's currency system is managed in a sense that is not true of the currency of the United Kingdom lies in the fact that the rupee is a token passing at a value above its intrinsic value and at the same time is unlimited legal tender. It is true that it is not practicable even to consider the limitation of the amount for which the rupee is legal tender. In this sense, therefore, the system must remain a managed one. But we demur altogether to the idea that because it is to this extent a managed system it must be a bad system. It is not, in fact, possible for the Government of India to manipulate the currency for their own ends, and they cannot add to the active circulation of the currency except in response to public demands.

"With the argument that India should be encouraged to absorb gold for the benefit of the world in general we do not propose to deal. The extent to which India should use gold must, in our opinion, be decided solely in accordance with India's own needs and wishes, and it appears to us to be as unjust to force gold coins into circulation in India on the ground that such action will benefit the gold-using countries of the rest of the world as it would be to attempt to refuse to India facilities for obtaining gold in order to prevent what adherents of the opposite school have called the drain of gold to India. In any case, these arguments (which it will be noted are mutually destructive) are irrelevant to the inquiry which we were directed to make and to the terms of reference, which confine us to a report on what is 'conducive to the interests of India.' They raise vast controversies upon subjects which are beyond our scope, while giving no reason for the adoption of either policy in India's own interest.

"We conclude therefore that it would not be to India's advantage to encourage an increased use of gold in the internal circulation."

Having arrived at this conclusion the commission proceed:—

"(vii) A mint for the coinage of gold is not needed for purposes of currency or exchange, but if Indian sentiment genuinely demands it and the Government of India are prepared to incur the expense, there is no objection in principle to its establishment either from the Indian or from the Imperial standpoint: provided that the coin minted is the sovereign (or the half-sovereign); and it is pre-eminently a question in which Indian sentiment should prevail.

" (viii) If a mint for the coinage of gold is not established, refined gold should be received at the Bombay Mint in exchange for currency."

Then follow two brief recommendations which epitomise the whole currency and exchange policy of India.

" (ix) *The Government should continue to aim at giving the people the form of currency which they demand, whether rupees, notes, or gold, but the use of notes should be encouraged.*

" (x) *The essential point is that this internal currency should be supported for exchange purposes by a thoroughly adequate reserve of gold and sterling."*

It will be noticed that the Commission suggest that the people should have the currency they desire but that—a gold currency being detrimental to India—the use of notes should be encouraged. The British Government in their own post-war currency problem have gone much further than this. Recognising that the continuance of a gold currency would be harmful, if not impossible, they have decreed that the people shall, nolens volens, have a paper currency. It is interesting to note that the democratic Government can act thus bureaucratically while the bureaucratic Government is recommended to act democratically, and tactfully to wean the people from their barren hunger for gold.

The remaining points of importance in the recommendations are as follows:—

Further Recommendations.—" (xi) No limit can at present be fixed to the amount up to which the Gold Standard Reserve should be accumulated.

"(xii) The profits on coinage of rupees should for the present continue to be credited exclusively to the Reserve.

"(xiii) A much larger proportion of the Reserve should be held in actual gold. By an exchange of assets between this Reserve and the Paper Currency Reserve, a total of about £10,000,000 in gold can be at once secured. This total should be raised as opportunity offers to £15,000,000 and thereafter the authorities should aim at keeping one-half of the total Reserve in actual gold.

"(xiv) The Indian branch of the Gold Standard Reserve in which rupees are now held should be abolished, the rupees being handed over to the Paper Currency Reserve in exchange for gold.

"(xv) The proper place for the location of the whole of the Gold Standard Reserve is London.

"(xvi) The Government should definitely undertake to sell bills in India on London at the rate of 1s. $3\frac{29}{32}$d. per rupee whenever called upon to do so.

"(xvii) The Paper Currency system of India should be made more elastic. The fiduciary portion of the note issue should be increased at once from 14 crores to 20 crores, and thereafter fixed at a maximum of the amount of notes held by Government in the Reserve Treasuries plus one-third of the net circulation, and the Government should take power to make temporary investments or loans from the fiduciary portion within this maximum in India and in London, as an alternative to investment in permanent securities.

"(xxix) The Secretary of State sells Council Drafts, not for the convenience of trade, but to provide the funds needed in London to meet the requirements of the Secretary of State on India's behalf.

"(xxx) The India Office perhaps sold Council Drafts unnecessarily at very low rates on occasions when the London balance was in no need of replenishment, but we do not recommend any restrictions upon the absolute discretion of the Secretary of State as to the amount of drafts sold or the rate at which they are sold, provided that it is within the gold points. The amount and occasion of sales should be fixed with reference to the urgency of the Government's requirements and the rate of exchange obtainable, whether the drafts are against Treasury balances or against the Reserves."

The recommendations thus made were designed to give India a Gold Exchange Standard, proof against both the appreciation and depreciation of the rupee and elastic both in providing increased currency in times of keen demand and relieving redundancy in times of slack trade.

As the Paper Currency Reserve grew, and as the Gold Standard Reserve continued to swell with the profits of coinage and the earnings of interest, the system would become stronger and stronger until no possible doubt could exist of the ability of Government to maintain the gold exchange value of the rupee against any storm.

As to the possibility of the rupee rising above its exchange value this could only happen in one of two ways; either by the abandonment of the Gold Standard by India's principal customers or by a rise in the bullion value of the rupee above one-fifteenth of a pound.

Neither contingency appeared remotely possible short of some immense catastrophe such as a war of unheard of dimensions involving the leading Western Nations.

Alas for the mutability of human affairs! While the recommendations of the Commission were under the consideration of Government and before any action had been taken—the impossible took place and the world was plunged into the greatest war in history.

CHAPTER V.

From the Outbreak of the War to 1920.

First Effects.—The first effects of the War * were the general dislocation of trade and the usual symptoms of widespread alarm—withdrawals of Savings Banks deposits, a demand for gold and a weakening of exchange. To meet the situation, Government at once came forward with offers of Reverse Councils of which £8,700,000 were sold up to the end of January 1915. In the following month, however, exchange strengthened, the Secretary of State was again able to sell Council drafts and the period of weakness was ended.

During the same period there was a lack of confidence in the note issue and in the first seven months of the War there was a reduction in the net circulation of currency notes to the extent of over 10 crores of rupees. But, with returning confidence, a steady increase took place and on 30th November 1919 the net circulation amounted to Rs. 178.93 crores as against Rs. 55.65 crores on 31st March 1915. Meanwhile, as the demand for gold was likely to prove embarrassing, about £1,800,000 being withdrawn between 1st and 4th August, the Government on 5th August suspended the issue of

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* *Vide* the report of the Babington-Smith Committee for details of the currency difficulties during and immediately after the War.

gold to private persons and thereafter notes were encashed in silver coin only.

Later Effects.—Whereas during the earlier days of the War the anxiety had been to maintain the exchange value of the rupee the difficulties that arose in 1916 were of a totally opposite nature. One of the first effects of the War was to paralyse export shipments, particularly those to Germany and Austria, which were cut off short by the outbreak of hostilities. Imports of course suffered a similar check but, during the first two years, were affected less than exports.

Thus, whereas, during the quinquennium ending March 1914, the average annual excess of exports over imports was over £52 millions, the excess from 1914-15 was only £29 millions while that from 1915-16 was still below the pre-war average at £44 millions.

By 1916, a great change had come over the situation. As most of the leading nations of the world were among the belligerents it was exceedingly difficult for India to obtain imports, the energies of the nations concerned being mainly directed to the maintenance of their armies in the field and of their own populations. On the other hand there was a keen demand for Indian foodstuffs, raw material and merchandise generally, so that, despite shortage of freight, considerable shipments went forward, the value of which was greatly increased by the enhanced level of prices.

The excess of exports over imports therefore increased rapidly to a figure materially above that which obtained before the War, the actual excesses being as follows:—

1916-17	£60,843,000
1917-18	£61,420,000
1918-19	£56,540,000

These large balances in India's favour were reflected in the strength of exchange and a keen demand for currency. This latter was further intensified by the necessity of providing funds for the payment of troops, the purchase of supplies and the financing of shipments to certain Dominions and, later, to the U. S. A. Again the practical stoppage of the imports of bullion on private account, due mainly to the disappearance of a free gold market in London, tended to increase still more the demand for silver.

These gold and silver imports averaged £24,000,000 annually during the quinquennium ending March 1914. During the following five years the imports fell to the following figures:—

1914-15	£12,313,000
1915-16	£6,984,000
1916-17	£1,357,000
1917-18	£15,277,000
1918-19	£53,000

Simultaneously with the greatly increased demand for silver there was a heavy fall in its production due, it is to be noted, not mainly to the War, but to internal conditions in Mexico.

Thus the production of silver in fine ounces (000 omitted) was as follows:—

		Mexico.	Rest of World.	Total.
Average	1910-1913	73,937	154,615	228,552
	1914	27,547	148,501	176,048
	1915	39,570	146,175	185,745
	1916	22,838	152,618	175,456
	1917	31,214	143,836	175,050

The combined effect of a greatly increased demand for silver and a diminished supply was seen in a rise in the price of silver. This was modified during the years 1914-17 by selling from China, which during this period exported a net amount of 77,000,000 standard ounces. But from 1918, China became a persistent buyer and prices tended to rise further, though this tendency was checked temporarily by legislation in the United States and Great Britain for controlling dealings in silver and stabilising the market price.

The withdrawal of control by both Governments in May 1919 led to a further sharp rise, accentuated by heavy buying by China. The Gold price of Silver therefore rose to still greater heights while, owing to the depreciation of the pound sterling, the sterling price stood proportionately higher.

The following figures will show the extent of the rise:—

In 1915 the highest price reached was 27¼d. per standard ounce.

By April 1916 it had risen to 35⅛d. and by December to 37d.

In August 1917 it exceeded 43d. at which point the bullion value of the rupee was equal to its exchange value at 1s. 4d.

In September 1917 the price was 55d., but the control regulations above referred to checked the rising tendency and between October 1917 and May 1919 the London quotation fluctuated between 41⅞d. and 50d.

On the removal of control the price rose to 58d. and with the progressive depreciation in sterling the London price rose in December 1919 to 78d. per ounce, which placed the bullion value of the rupee at 2s. 5d. sterling.

Measures taken: 1. To stabilise exchange.—As the excess of exports tended to raise exchange and as in the absence of free trading in gold, exchange might have been subject to a sharp upward movement, on 3rd January 1917 Government in continuation of its policy of maintaining stability fixed the rate for the sale of Council drafts at 1s. 4¼d. The measures taken, which were such as in ordinary times would probably have proved ineffective, were in fact, in the unusual circumstances obtaining, sufficiently successful.

It was however impossible to maintain the exchange value of the rupee at a figure below its bullion value as this would have led to the wholesale melting down of rupees and would have imperilled the very existence of the currency. Accordingly, as the constantly rising price of silver brought the bullion value of the rupee up to its exchange value it was necessary to raise the rate for Council drafts, which in the circumstances of a strong exchange market, was instantly effective in raising the rate of exchange.

The minimum rate for telegraphic transfers was therefore raised as follows:—

	s.	d.		s.	d.
Jan. 3rd, 1917	1	$4\frac{1}{4}$	Aug. 12th, 1919	1	10
Aug. 28th, 1917	1	5	Sept. 15th, 1919	2	0
April 12th, 1918	1	6	Nov. 22nd, 1919	2	2
May 13th, 1919	1	8	Dec. 12th, 1919	2	4

On the increase to 2s. 4d. the Secretary of State announced his readiness to sell Reverse Councils at 2s. $3\frac{29}{32}$d., a step that was afterwards very strongly condemned and which it would certainly appear difficult to justify.

2. To provide currency.—The difficulties of Government were by no means confined to the regulation of exchange. It was also necessary to provide increased currency on an exceptional scale, and that in the face of a prohibitive silver market. But while the purchase and coinage of silver on a heavy scale was essential, the currency circulation could also be increased by a greater use of gold and—what was more important—by a greater issue of paper currency without a metallic backing. Both these expedients were however limited by the necessity of providing for immediate encashment in rupees, a failure to do which might have had a very serious effect on public confidence.

Until February 1916 there was no demand for rupee coinage and the silver purchases for the year 1915-16 were therefore very small. In 1916-17 the Secretary of State made heavy purchases, but the following year was one of greater difficulty owing to the dearth of supplies and the competition of foreign buyers, Indian buyers having been put out of the market by the prohibition on 3rd September 1917 of the import of silver on private account.

Accordingly representations were made by the Imperial Government to the Government of the United States of America as a result of which on 23rd April 1918 the United States Congress passed the Pitmann Act authorising the sale of Government silver to a maximum of 350,000,000 silver dollars at 101½ cents per ounce.

The amount of silver in standard ounces acquired from this source and from the open market from 1st April 1915 to 30th November 1919 was as follows:—

	Open Market	From U. S. Reserve
1915-16	8,636,000	
1916-17	124,535,000	
1917-18	70,923,000	
1918-19	106,410,000	152,518,000
1919—30th Nov. 19	14,108,000	60,875,000
	324,612,000	213,393,000

The total amount of silver purchased for currency purposes was therefore 538,005,000 standard ounces.

In the direction of the increased use of gold coin and increased holdings of gold in the Paper Currency Reserve an Ordinance was issued on 29th June 1917 requiring all gold imported into India to be sold to Government. As the rate fixed for purchase took no account of the depreciation of sterling, this Ordinance soon operated as a prohibition of import on private account. Sovereigns were issued for financing of certain crops in 1917 and again in 1918 and in 1918-19, 2,110,000 gold mohurs and 1,295,000 sovereigns were coined in Bombay.

After the War the removal of the embargo on the export of gold by the United States Government on 9th June 1919 and the freeing of the Dominions Markets for gold enabled India to obtain a larger supply. Further on 15th September 1919 the rate paid to private importers by the Government of India was increased to an effective point so that imports of gold on private account began to come forward again, the gold so obtained being sold to the public by Government.

Of much greater importance than the attempts to increase the circulation of gold were the steps taken to increase the issue of Paper Currency.

Up to the War the invested portion of the Paper Currency Reserve—as distinct from the metallic reserve in gold and silver—was limited to 14 crores of rupees. Between November 1915 and November 1919 the invested portion was increased nine times to a final figure of Rs. 120 crores of which Rs. 20 crores could be invested in securities of the Government of India. This legislation paved the way for an enormous increase in the currency circulation, which was further stimulated by the issue of notes for Re. 1 and Rs. 2|8. The latter were never popular but the gross circulation of the one-rupee notes in 1919 exceeded Rs. 10 crores.

The extent of the increase in circulation and, at the same time, decrease in the percentage of metallic backing appears from the following figures:—

Lakhs of Rupees.

		Gross Notes Circulation.	Reserve.			Percentage of Total Metallic Reserve to Gross Notes Circulation.
			Silver.	Gold.	Securities.	
31st March	1914	66,12	20,53	31,59	14,00	78.9
"	1915	61.63	32,34	15,29	14,00	77.3
"	1916	67,73	23,57	24,16	20,00	70.5
"	1917	86,38	19,22	18,67	48,49	43.9
"	1918	99,79	10,79	27,52	61,48	38.4
"	1919	153,46	37,39	17,49	98,58	35.8
30th Nov.	1919	179,67	47,44	32,70	99,53	44.6

It will be noted that on 31st March 1918 the metallic reserve percentage was 38.4 per cent., only Rs. 10.79 crores of silver being available. This corresponded with a period of very bad War news (when the last great German advance was gaining ground) and caused a run on the currency offices, particularly in Bombay and Lahore. By the first week in June the silver coin available was reduced to Rs. 4 crores and it was only by a narrow margin that inconvertibility was avoided. From July however the silver from the U. S. Government Reserves began to arrive and the situation was saved, although for a period paper stood at a discount in the bazaars, the rate in some places being reported as high as 19 per cent.

In 1919 then, the position was that the problem of providing sufficient currency was being satisfactorily met but that with the constantly rising price of silver there was no prospect of stabilising exchange.

The Babington Smith Committee.—In these circumstances the Secretary of State on 30th May 1919 appointed a Committee under the Chairmanship of Sir H. Babington Smith to "examine the effect of the war on the Indian exchange and currency systems and practice, and upon the position of the Indian note-issue," and to make recommendations with a view to "maintaining a satisfactory monetary circulation, and to ensuring a stable gold exchange standard." Mr. H. Denning, now Comptroller of the Currency, and Mr. Kisch of the India office were the secretaries to the Commission.

The Committee reported on 22nd December 1919. The majority report was signed by 10 members while a minority report was presented by Mr. Dadiba Merwanjee Dalal (now Sir Dadiba Dalal and recently High Commissioner for India). The majority report begins by considering the possibility of issuing a rupee having a lower silver content than the present rupee which would have enabled exchange to be fixed at a low level in spite of the rise in the price of silver. The conclusion reached was that such a measure was totally impossible, especially in a country where the fineness of the rupee was known to every village goldsmith and had been unaltered since 1835. The report adds that, in accordance with Gresham's law, the new "debased" rupee would drive the present rupee out of circulation.

For the same reasons the issue of 2 or 3 rupee pieces with a reduced proportionate silver content was considered impossible. This proposal was indeed merely debasement under a thin disguise and there is every reason to think that Gresham's Law would unquestionably have operated and that the most disastrous consequences would have resulted.

The majority therefore considered that it was necessary to fix a rate above the probable bullion value of the rupee and that any rate below this level must *ipso facto* be ruled out of court.

The more important recommendations in the majority report were as follows:—

1. Exchange to be stabilised at Rs. 10 to one gold sovereign, i.e., the rupee to be linked to gold, not sterling.

2. The Government of India to be authorised to sell Reverse Councils, during periods of exchange weakness, at par less the expense of shipping gold from India to the United Kingdom.

3. Government to continue to give the people the form of currency which they demand, whether gold, rupees or notes but the use of gold not to be encouraged—except temporarily if there be any difficulty in meeting the demand for rupees.

4. The Bombay Mint to be re-opened for the coinage of sovereigns and half sovereigns.

5. The obligation to give rupees for sovereigns to be withdrawn.

6. Free import and export of gold.

7. Free import of silver but a continuance of temporary embargo on export.

8. The metallic portion of the Paper Currency Reserve to be not less than 40 per cent. of the gross

circulation. Such metallic reserve to be held in India. The fiduciary portion of the reserve to be invested in redeemable Indian and British Empire Government Securities, mainly of not more than 1 year maturity. The amount of the Indian Government Securities so held not to exceed Rs. 20 crores. Ful facilities to be given for the encashment of notes but Government to have the opion of redeeming its notes in full legal tender gold or silver coin.

9. To give seasonal elasticity, notes to be issued as loans to the Presidency banks up to Rs. 5 crores on the security of export bills.

10. No limit to be fixed to the amount to which the Gold Standard Reserve be accumulated. The Reserve to contain "when practicable....a considerable portion of gold." Up to one half of such gold to be held in India. The invested portion to be held in London and to consist of British Empire Government Securities (other than those of the Government of India) having a maturity of not more than 12 months.

11. Opportunities to be given to the public to exchange sovereigns and gold mohurs in their possession at the rate of 15 rupees—the resulting loss to be met by Government.

For a short period after the presentation of this report exchange remained firm, the highest point being attained in February 1920 when a rate of 2s. 10d. sterling was reached. Thereafter weakness set in and within 6 months of the report, the rate had slumped to 1s. 9d. sterling (equivalent to about 1s. 5d. gold, owing to sterling itself being at that time considerably depreciated). On 7th March 1921 the lowest point was touched viz., 1s. $2\frac{7}{8}$d. (under 1s. 0d. gold) and thereafter the rate fluctuated round about 1s. 4d. rising gradually in 1924 to the region of 1s. 6d. The main recommendation of the Committee therefore became a dead letter, stabilisation at 2s. 0d. having become a total impossibility almost from the issue of the report.

The proposed high stabilisation of the rupee having been exceedingly unpopular in many quarters it is natural that the collapse called down upon the heads of the majority a flood of adverse criticism. It is not the purpose of this book to enter the arena of politico-economic discussion as that would involve a digression of inordinate length and would be foreign to the main purpose of explaining as briefly as possible the Indian Exchange and Currency System by tracing its gradual evolution from a system of free silver. Moreover, the period during which the Commission sat was one of extreme unsettlement. Statesmen the world over were faced by conditions for which no precedent existed, and their most momentous conclusions now survive only as monuments to the fallibility of human intelligence.

We should therefore be chary of displaying that wisdom—which we all so abundantly possess—the wisdom after the event.

The main miscalculation of the Committee was in regard to the level of prices. Their recommendations were based on a continuance of the existing high level of prices and had this anticipation been realised it is probable that a high level of exchange would have been the best solution. It would have caused less dislocation than a reduction in exchange with a still further rise in prices. As it was, the high exchange did in fact moderate the rise of prices in India and when the slump in exchange took place it synchronised with a slump in world prices so that despite lower exchange the Indian price level moved downwards though not as rapidly as that of other countries.

Thus, taking the last pre-war figure as 100, the price level from 1920 onwards was as follows:—

	U. K.	U. S. A.	India.
1920	251	239	204
1921	155	149	181
1922	131	158	180

That the Committee were alive to the fact that a break in prices would invalidate their proposals appears from the following extract from paragraph 51:—

"It seems probable that prices will remain at a high level for a considerable time......but if, contrary to this expectation, a great and rapid fall in world prices were to take place......it would be necessary to consider the problem afresh and take the measures which might be required by the altered circumstances."

Later in their report, paragraph 58, the majority fully recognised that "circumstances are abnormal and that it is extremely difficult to foresee future developments," so that it might be suggested that "policy should wait upon events." "But," they add, "in our terms of reference we are directed to make recommendations with a view to securing a stable gold exchange standard and we do not think that it would be an adequate discharge of our responsibilities to submit proposals which did not aim at securing stability in the near future, if, as we believe, such a result is attainable."

This is a curious statement. If the last few words represent their considered opinion, then there seems no need for the preamble on the "adequate discharge" of responsibilities. If, on the other hand, there existed some doubt as to the desired result being obtainable, it was surely better to let "policy wait upon events" than to feel compelled to make some sort of recommendation, which if ineffective would inevitably prove both costly and harmful.

The Minority Report.—The minority report is very largely devoted to criticism of the currency policy of the Government of India during the War. The arguments employed open a considerable field for interesting discussion, but it would be foreign to the purpose of this book to enter this field or to follow in detail the trenchant criticisms, which Sir Dadiba levels at the Finance Department.

His view was that Government should have floated a British Government loan in India instead of "watering" the paper currency, that gold should have been allowed to flow freely into India, that in that case it would never have been necessary to raise the exchange value of the rupee beyond 1s. 8d. and that the rupee should be again stabilised on the basis of the old exchange rate of 1s. 4d.

The following are the principal recommendations of the minority report:—

1. The standard to be 15 rupees to one sovereign or gold mohur.

2. So long as the price of silver in New York is over 92 cents, Government to coin, instead of the present rupees, 2-rupee pieces of reduced fineness.

3. Free export and import of gold and silver.

4. Council drafts not to be sold in excess of the amounts needed for Home charges as defined in the budget.

5. Reverse Councils to be sold at 1s. $3\frac{29}{32}$d.

6. Sterling investments in the Paper Currency Reserve to be sold and the proceeds remitted to India in gold.

From a comparison between the majority and minority reports it will be seen that there are two main lines of cleavage, viz., (*a*) the desirability and (*b*) the possibility of reducing exchange to the pre-war level of 1s. 4d.

As to the desirability of 1s. 4d. as against 2s. 0d. as the exchange ratio, the question turns largely on the level of prices.

If the level of prices remained unaltered a jump in exchange from 1s. 4d. to 2s. 0d. would have proved absolutely disastrous to Indian industries. Suppose however there has been, in gold using countries, a rise in prices of 150 per cent. and an equal or greater rise in wages. And suppose in India a rise of 100 per cent. in prices and a smaller rise in wages (in Europe and America for reasons of labour shortage, wages tended to rise more than prices, in India generally less) then the nominal alteration in exchange may in reality tend to cancel the alteration in price levels and leave the real exchange ratio more or less *in statu quo*.

This is not intended to mean that it would have been possible in 1919 to arrive at any sort of arithmetical calculation from the level of prices to an equivalent exchange ratio, as both prices and exchange were then in a state of flux. It is merely to emphasise the fact that prices are an important factor in arriving at the "best" rate of exchange, and that, until the general course of prices is known, it is prudent to "wait and see." This however, let us admit once more, is wisdom after the event.

As to the *possibility* of reducing exchange it could only be done by coining silver coins of reduced fineness, which the majority, for the reasons given above, considered impossible.

The minority report, however, is entirely based on the possibility of issuing such coins and of maintaining them on a parity with the existing rupee. And, though there were the strongest reasons for believing that any such attempt would fail disastrously and do irreparable injury to Indian credit, Sir Dadiba adduces no argument in support of his view and no explanation as to how the obvious dangers of debasement were to be avoided.

His report must therefore be read rather as an expression of his desire to return to 1s. 4d. if it were possible, than as a practical suggestion for meeting the situation which confronted the Commission.

CHAPTER VI.

THE HILTON YOUNG COMMISSION.

The effect of the fall in prices.—The recommendations of the Babington-Smith Commission for stabilisation at Rs. 10 to the gold sovereign, were, as we have seen, swept away by the great fall in world prices which characterised the latter half of 1920. Government, having accepted the recommendations, felt compelled to support Exchange and Reverse Councils were freely sold, firstly at a rate which made allowance for the discount in sterling and latterly at 1s. 11$\frac{29}{32}$d., which represented the approximate rate which would obtain on sterling being again raised to gold parity.

The balance of trade however turned so heavily against India that attempts to arrest the decline proved futile and, at the end of September 1920, the offer of Reverse Councils was withdrawn and exchange was left to find its own level. The sales of Reverse Councils up to that time totalled £55,382,000, while during the same period note circulation was reduced from Rs. 185 crores to Rs. 158 crores.

With the removal of Government support exchange plunged downwards, until, as already mentioned, a rate of below 1s. 0d. gold was reached in 1921.

But, while Reverse Councils had been withdrawn, the contraction of the Currency continued during 1921-22 and 1922-23 and this succeeded (except for a short period in 1921) in holding exchange steady at about 1s. 4d. sterling until the balance of trade again turned in India's favour.

The immense changes that took place in the balance of trade between 1919 and 1925 are set out here. These movements were so sudden and far-reaching that it is not surprising that they played havoc with a system already thrown out of gear by the strain of war and the huge rise in the price of silver.

IN CRORES OF RUPEES.

Year.	Exports of Merchandise.	Imports of Merchandise.	Balance.	Imports of Treasure	Nett Balance.
1919-20	327	301	+126	11	+115
1920-21	258	335	- 77	1	—78
1921-22	245	266	- 21	12	—33
1922-23	314	224	+ 90	59	+ 31
1923-24	362	217	+145	48	+ 97
1924-25	398	243	+155	64	—91

It will be seen from these figures that from 1922-23 trade was again running in India's favour, and that over the next 3 years the favourable balance continued to increase.

The course taken by exchange was as follows:—

During 1922 the rate fluctuated round about 1s. 3½d. sterling and 1s. 2d. gold.

During 1923 it was uniformly slightly above 1s. 4d. sterling and 1s. 3d. gold.

In 1924 it remained till July at about 1s. 3d. gold, though the sterling equivalent was somewhat higher than in the previous year owing to a temporary drop in the cross rate.

With the latter half of 1924 began a further rise in the sterling rate and as, in 1925, sterling crept up towards parity, the rupee attained a rate of 1s. 6d. gold.

The following figures, showing the movements of exchange from July 1924 to July 1925, are of somewhat unusual importance:—

		Sterling.	Gold.
		s. d.	s. d.
1924	1st April	1 $4\frac{21}{32}$	1 $2\frac{23}{32}$
1924	1st July	1 5	1 $3\frac{1}{8}$
1924	1st October	1 $5\frac{23}{32}$	1 $4\frac{1}{4}$
1925	1st January	1 $6\frac{1}{16}$	1 $5\frac{21}{32}$
1925	1st April	1 $5\frac{27}{32}$	1 $5\frac{17}{32}$
1925	1st July	1 $6\frac{3}{32}$	1 $6\frac{1}{16}$

It will be seen from these figures that when in April 1924 exchange was nominally over the old pre-war parity the actual gold value of the rupee was under 1s. 3d. Again in July 1s. 5d. sterling was reached but still the gold rate was only 1s. $3\frac{1}{8}$d.

In October 1924 the rates were approximately 1s. 6d. sterling and 1s. 4d. gold and somewhere about this period it must have been necessary for Government to take a definite decision at which of these two rates to peg the rupee. Some form of temporary stabilisation was of course essential. The ship had been left to the mercies of the storm because no moorings could have held her but, the storm once over, she had to be moored again as soon as it could safely be done.

It was evidently decided at about that time to stabilise at 1s. 6d. sterling and, though this was equivalent to only 1s. 4d. gold, the rapid recovery of sterling brought the rupee to an approximate level of 1s. 6d. gold by the middle of 1925.

From that time exchange ruled very firm and Government were compelled to purchase sterling heavily to keep the rupee down to its theoretical higher specie point 1s. $6\frac{5}{32}$d , at which rate it remained unchanged to the end of the year.

Meantime the position of affairs left by the Babington-Smith report and the subsequent slump in exchange was profoundly unsatisfactory. The official rate of 10 rupees to the pound had become wholly fictitious and trade was hampered by uncertainty as to the future, which also operated to hinder the normal movements of capital. It was therefore desirable that the whole subject should be again thoroughly reviewed and that, after the vagaries of 10 years, stabilty should be attained once more.

At the same time, while it was desirable to lose no time in stabilising, it was none the less necessary to be sure that some degree of calm had been attained. The unhappy experience of the last Committee, in seeing their barely completed edifice swept away by the greatest slump in history was sufficient to deter Government from hastening matters until the storm had clearly blown itself out.

The Commission appointed.—In 1925 however, in the conditions of gradually steadying rates to which we have just referred, Government felt that they could once more venture into the field. A new Royal Commission was therefore appointed on August 25th under the Chairmanship of the Rt. Hon. E. Hilton Young, M. P., a well-known Financial authority.

The Commission was a very representative one, though its announcement led to some criticism from Bombay, that their interests were inadequately represented.

The members were Sir Rajendra Nath Mookerjee, a well known Calcutta merchant and public man, Sir Norcot Warren, senior Managing Governor of the Imperial Bank of India, Sir Reginald Mant of the Council of India, Sir M. B. Dadabhoy, an eminent Bombay public man, Sir Henry Strakosch, well known as an authority on Finance, Sir A. R. Murray, one of the leaders of Commerce in Calcutta, Sir Purshottam Thakurdas, perhaps the most striking figure in the commercial world of Bombay, Mr. J. C. Coyajee, Professor of Political Economy and Mr. W. E. Preston, General Manager in London of the Chartered Bank of India, Australia and China.

In addition to Sir Norcot Warren, no less than four other members of the Commission were Governors or Directors of the Imperial Bank, viz., Sir Rajendra Nath Mookerjee, Sir M. B. Dadabhoy, Sir A. R. Murray and Sir Purshottamdas Thakurdas.

The Commission sat in India from November 1925 and subsequently met in London, where they heard evidence not only from British experts but also from some of the leading American experts who came over for that purpose. They reported on 1st July 1926.

The report was signed by all the Commissioners, but Sir Purshottamdas Thakurdas signed subject to a minute of dissent. The following is the summary of recommendations :—

Recommendations.—(1). "The ordinary medium of circulation should remain the currency note and the silver rupee, and the stability of the currency in terms of gold should be secured by making the currency directly convertible into gold, but gold should not circulate as money.

"(2). The necessity of unity of policy in the control of currency and credit for the achievement of monetary stability involves the establishment of a Central Banking system.

"(3). The Central Banking functions should be entrusted to a new organisation, referred to as the Reserve Bank.

"(4). Detailed recommendations are made as to the constitution and functions and capacities of the Bank.

"(5). The outlines of a proposed charter are recommended to give effect to the recommendations which concern the Reserve Bank.

"(6). Subject to the payment of limited dividends and the building up of suitable reserve funds, the balance of the profits of the Reserve Bank should be paid over to the Government.

"(7). The Bank should be given the sole right of note of issue for a period of (say) 25 years. Not later than 5 years from the date of the charter becoming operative, Government notes should cease to be legal tender except at Government Treasuries.

"(8). The notes of the Bank should be full legal tender, and should be guaranteed by Government. The form and material of the note should be subject to the approval of the Governor-General in Council. A suggestion is made as to the form of the note.

"(9). An obligation should be imposed by statute on the Bank to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee, but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold is required.

"(10. The conditions which are to govern the sale of gold by the Bank should be so framed as to free it in normal circumstances from the task of supplying gold for non-monetary purposes. The method by which this may be secured is suggested.

"(11). The legal tender quality of the sovereign and the half-sovereign should be removed.

"(12). Government should offer "on tap" savings certificates redeemable in 3 or 5 years in legal tender money or gold at the option of the holder.

"(13). The paper currency should cease to be convertible by law into silver coin. It should, however, be the duty of the Bank to maintain the free interchangeability of the different forms of legal tender currency, and of the Government to supply coin to the Bank on demand.

"(14). One-rupee notes should be re-introduced and should be full legal tender.

"(15). Notes other than the one-rupee note should be legally convertible into legal tender money, i.e., into notes of smaller denominations or silver rupees at the option of the currency authority.

"(16). No change should be made in the legal tender character of the silver rupee.

"(17). The Paper Currency and Gold Standard Reserves should be amalgamated, and the proportions and composition of the combined Reserve should be fixed by statute.

"(18). The proportional reserve system should be adopted. Gold and gold securities should form not less than 40 per cent. of the Reserve, subject to a possible temporary reduction, with the consent of Government, on payment of a tax. The currency authority should strive to work to a reserve ratio of 50 to 60 per cent. The gold holding should be raised to 20 per cent. of the Reserve as soon as possible and to 25 per cent. within 10 years. During this period no favourable opportunity of fortifying the gold holding in the Reserve should be allowed to escape. Of the gold holding at least one-half should be held in India.

"(19). The silver holding in the Reserve should be very substantially reduced during a transitional period of 10 years.

"(20). The balance of the Reserve should be held in self-liquidating trade bills and Government of India securities. The "created" securities should be replaced by marketable securities within 10 years.

"(21). A figure of Rs. 50 crores has been fixed as the liability in respect of the contractibility of the rupee circulation. Recommendations are made to secure that an amount equal to one-fifth of the face value of any increase or decrease in the number of silver rupees in issue shall be added to or subtracted from this liability, and the balance of profit or loss shall accrue to or be borne by the Government revenues.

"(22). The Issue Department of the Reserve Bank should be kept wholly distinct from its Banking Department.

"(23). The Reserve Bank should be entrusted with all the remittance operations of the Government. The Secretary of State should furnish in advance periodical information as to his requirements. The Bank should be left free, at its discretion, to employ such method or methods of remittance as it may find conducive to smooth working.

"(24). During the transition period the Government should publish a weekly return of remittances made. A trial should be made of the system of purchase by public tender in India.

"(25). The cash balances of the Government (including any balances of the Government of India and of the Secretary of State outside India), as well as the banking reserves in India of all banks operating in India, should be centralised in the hands of the Reserve Bank. Section 23 of the Government of India Act should be amended accordingly.

"(26). The transfer of Reserve assets should take place not later than 1st January 1929, and the Bank's obligation to buy and sell gold should come into operation not later than 1st January 1931.

"(27). During the transition period the currency authority (i.e., the Government until the transfer of Reserve assets and the Bank thereafter) should be under an obligation to buy gold and to sell gold or gold exchange at its option at the gold points of the exchange. This obligation should be embodied in statutory form, of which the outline is suggested.

"(28). Stabilisation of the rupee should be effected forthwith at a rate corresponding to an exchange rate of 1s. 6d.

"(29). The stamp duty on bills of exchange and cheques should be abolished. Bill forms, in the English language and the vernacular in parallel, should be on sale at Post Offices.

"(30). Measures should be taken to promote the developments of banking in India.

"(31). Every effort should be made to remedy the deficiencies in the existing body of statistical data."

There is no need to deal here with the question of the proposed new banking authority as we are concerned rather with the system itself than its management, but a few words are necessary on the meaning of the other recommendations.

The Gold Bullion Standard.—The pre-war system of Indian currency was a silver and note currency with a moral but not a legal responsibility upon Government to provide sterling at a fixed maximum rate when needed for the purposes of foreign trade.

The proposed new system will be a silver and note currency directly based upon gold, but without the circulation of gold coins. Gold will thus be freely available at fixed rates, for any purpose and subject only to a minimum quantity of 400 ounces being taken. The currency authority will also be an open buyer of gold at fixed rates subject to the same minimum.

At the same time the Commission recommend that the new Bank notes should no longer be convertible by law into silver coin, though no doubt there would for years to come be no obstacle to so doing. This is a bold and far-reaching proposal. At present the paper currency is based on the rupee and is convertible into rupees and only into rupees. But the rupee itself being a weak and unstable foundation is buttressed with various Reserves which in their turn maintain it on a fixed level in relation to gold.

The new proposal is to dethrone the rupee, other than in its real character of a note printed on silver, and rest all currency notes directly on gold bullion, available here in India. In this way the Indian currency system will be brought into line with the modern practice, whereby the gold resources are held by the Central Banking authority and paper and the cheaper metals only are in circulation.

There will perhaps remain in some quarters a sentimental regret at the lack of an actual gold currency but the reasons against it are overwhelming* and it has moreover long ceased to be the hall-mark of an advanced nation.

Great Britain, for example, having attained to a gold currency, having in fact led the world in adopting gold as her standard, has now abandoned the actual circulation of gold coins. Other nations have done the same. So that a gold currency may be regarded as a stepping-stone to the modern form of currency, which is paper

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* See Chapter IV, Page 33.

and the cheaper metals in circulation with gold in the central reserve.

If India is able to step straight up to the most modern currency practice, without a period of gold currency, she will have been saved a great deal of expense but time alone will show whether or not this will be possible. For while a gold currency is certainly inadvisable at present, there is none the less great need of a gold unit. In England, there is no gold sovereign in circulation but the equivalent note stands for what was once a gold coin and is still the accounting unit. So that while no one desires gold for ordinary transactions, there exists the knowledge that the five-pound note and the Bradbury are, subject to a certain minimum of quantity, definitely exchangeable for sovereigns or for the actual amount of gold which sovereigns used to contain.

But in India the position will be less clear to the man in the street—and all currency regulations should as far as possible be clear to the man in the street. The silver rupee will represent—what? It will represent 8.4751 grains of gold or some fraction of a tola. It will represent 1s. 6d., provided sterling is on a par with gold. It will represent one rupee's worth of gold—which is coming very close to saying that it will represent one silver rupee. It would be very much simpler and would fix the fact of gold stability more clearly in the public eye if the accounting unit had been a gold instead of a silver coin. It is true that most other accounting units are silver, but in every case gold coins such as 5-dollar and 20-franc gold pieces have been in circulation.

The currency commission have been fully alive to the difficulty and have attempted to overcome it by proposing the issue of savings certificates giving the alternative of encashment in rupees or in gold—by weight. If this succeeds it may be that a gold currency will be avoided altogether but, if not, then it may be necessary to introduce one later, when greater gold resources and less outstanding silver coin make the experiment less dangerous than at present.

But with the situation as it is to-day it would be hazardous for India to adopt a system which, at a time of crisis, results in the gold resources being scattered uselessly over the length and breadth of the land, instead of being centralised in the vaults of the Central Bank available to allay the crisis.

While however the report aims at putting India on a footing in currency matters with the leading nations of the world it must not be overlooked that another special difficulty affects this country, that does not obtain in Great Britain. Namely, that while gold bullion is to be the legal standard and the basis of the note issue, the silver rupee is to remain legal tender without limit. This is in striking contrast to the limit of forty shillings for which silver is legal tender in Great Britain.

It is however essential that nothing should be done to impair the prestige of the rupee and for that reason it would be impossible to set a limit on the amount for which rupees could be tendered. For while it is to be hoped that the public may be led gradually into recognising gold as the currency standard and notes and silver as token currency, this process will take many years and during that time nothing must be done to shake public confidence in the existing currency. It is peculiarly a case where it is well not to be off with the old love until on with the new.

But while the limitation of the rupee as legal tender is not in sight the demand for rupees may be expected to diminish and the report advocates the gradual contraction of the stock. It is proposed that the silver held in the reserve shall not exceed the following scale or 10 per cent. of the liabilities of the Issue Department whichever shall be greater:—

First three years	Rs. 70 crores
Third to Sixth year	„ 50 „
Sixth to Tenth year	„ 35 „
Thereafter	„ 25 „

The Amalgamation of the Reserves.—With regard to the constitution of the Reserve it is proposed to incorporate the Gold Standard Reserve in the Paper Currency Reserve, the whole Reserve being held by the Central Banking authority.

The Paper Currency Reserve as on 30th April 1926 was as follows:—

	Rs. Crores
Silver	85
Rupee Securities	57
Sterling Securities	21
Gold	22
	185

The Gold Standard Reserve stood at £40 millions, invested in sterling securities.

The Gold and Sterling securities in the Paper Currency Reserve are valued at 2s. exchange—the statutory rate. Taking them at 1s. 6d. and adding the Gold Standard Reserve, the figures as on 30th April 1926 stand as follows:—

	Rs. Crores.
Silver	85
Rupee Securities	57
Sterling Securities	81
Gold	30
	253
Paper Currency outstanding	185
Surplus	68

The Reserves will thus be seen to have a surplus of Rs. 68 crores over and above the amount of the Paper Currency. The proposals of the Commission however will, if successful, tend to a gradually diminishing use of silver rupees. Provision must therefore be made for removing redundant rupees from the currency and, a reserve is necessary for this purpose. The Commission received estimates of the total amount of existing rupees as from Rs. 350 to Rs. 400 crores of which Rs. 150 crores were needed for circulation.

The balance, less Rs. 18 crores which, as we shall see, are to be taken over by Government from the Paper Currency Reserve are a potential liability for redemption in gold.

For this purpose the Commission reckoned the liability as Rs. 50 crores to be applied in the following manner. The Bank to have the right to deliver surplus rupees to Government and for each 5 rupees delivered to receive in exchange notes gold, or gold securities for 4 rupees. The difference of one rupee in five would be charged against the Reserve Fund so that the Rs. 50 crores set aside for rupee redemption would be sufficient to allow of the redemption of Rs. 250 crores.

Conversely the Bank will be able to obtain rupees from Government on payment of 4 rupees in notes or gold for each 5 rupees obtained.

We have seen that the surplus assets in the new combined reserve will amount to Rs. 68 crores of which Rs. 50 crores is earmarked against rupee redemption. The Commission recommended that Government should take over the balance Rs. 18 crores from the silver in the Reserve, including the whole of the silver bullion amounting to about Rs. 8 crores. Therefore the item " Silver Rs. 85 crores " will be reduced to " Silver Coin Rs. 67 crores. "

Further the Commission recommended a minimum gold reserve percentage of 40 per cent., subject to a possible temporary reduction, and it was therefore desirable that the Bank should open with gold assets well above the minimum percentage. It was therefore recommended that Government should replace Rs. 7 crores of created rupee securities by gold securities—if necessary, as a temporary measure for 2 years only, by gold securities created *ad hoc*.

After making these adjustments, the final balance sheet of the Reserve Account will be as follows:—

LIABILITIES.		ASSETS.	
Note Issue	185	Silver Coin	67
Rupee Redemption	50	Rupee Securities	50
		Gold Securities	88
		Gold	30
	235		235

It was further proposed that the gold holding should be increased to 25 per cent. within 10 years and the rupee coin, as abovementioned, reduced to Rs. 25 crores or 10 per cent. of the liabilities, whichever is the greater, within the same period.

The Commission further recommended stabilisation of the rupee in relation to gold at 1s. 6d.

The minute of dissent signed by Sir Purshottamdas Thakurdas showed a cleavage on two points.

1. He favoured the development of the Imperial Bank of India as the Central Banking authority, rather than the creation of a new Reserve Bank.

2. He recommended stabilisation in relation to gold at 1s. 4d. per rupee.

The first point is one which, as stated above, it is not intended to deal with here.

The second point—1s. 6d. or 1s. 4d.—is discussed in the next chapter.

CHAPTER VII.

1s. 4d. or 1s. 6d.

The Adjustment of Prices.—This chapter is not intended as propaganda for either 1s. 6d. or 1s. 4d. It does no more than set out the facts of the situation without attempting to arrive at any definite conclusion as to which rate is the more desirable. In reality there is only one real issue, namely whether the level of prices in India is adjusted to 1s. 6d. or not, and the answer to this question depends on the correct reading of certain data which are exceedingly difficult to obtain and, when obtained, equally difficult to interpret. The writer makes no claim to being in possession of the necessary data and consequently does not arrogate to himself the right to say what conclusions are to be drawn.

A great deal of literature has been issued in favour of a reversion to 1s. 4d. but this is necessarily of a type suitable for public propaganda and therefore deals with the problem in somewhat general terms. The arguments on both sides are, however, set out at length and in considerable detail in the majority and minority reports and the reader is referred to these for a full understanding of the main issue. All that this chapter attempts to do is to establish the fact that the whole argument turns on the adjustment or non-adjustment of Indian prices to world prices.

If prices are adjusted to a ratio of 1s. 6d. then there can be no reason for any alteration from what is *ex hypothesi* the natural rate, but if prices are still adjusted to 1s. 4d. then that is the natural rate and a higher ratio will be harmful to Indian interests.

Both majority and minority reports agree on the vital importance of this question of adjustment.

Thus the majority report, after recommending that the rupee be stabilised in relation to gold at a rate corresponding to an exchange rate of 1s. 6d. for the rupee, continues:—

"The chief reason for this recommendation is our conviction, which has been formed and cumulatively reinforced during the progress of our inquiry, that, at the present exchange rate of about 1s. 6d., prices in India have already attained a substantial measure of adjustment with those in the world at large, and as a corollary, that any change in the rate would mean a difficult period of re-adjustment, involving widespread economic disturbance, which it is most desirable in the interests of the people to avoid, and which would in the end be followed by no countervailing advantage.

"We shall proceed to discuss a number of relevant issues, which have been raised in this connection and we shall examine the question from various angles; but we wish to make it clear at the outset that the central, and as it seems to us the decisive, factor is the extent to which the prevailing rate of exchange is reflected in internal prices. We are unanimous in holding the view and, indeed, it is a proposition which it would be difficult to controvert 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. The further proposition that such substantial adjustment has been secured, is a question of fact, as to which we shall now adduce the evidence on which our conviction is based."

The minority report recognises the same thing.

"The main point for examination," writes Sir Purshottamdas, "is whether there are any economic adjustments to the current rate of exchange incomplete and which, after stabilisation of the rupee at 1s. 6d. will involve a disturbance of existing conditions."

He goes on to conclude that prices and wages are not adjusted to a ratio of 1s. 6d. and consequently that an attempt to maintain exchange at that figure would involve a period of hardship and industrial disturbance.

The cleavage on this question of the ratio might have remained the subject of reasonable economic discussion had it not unfortunately raised a point of intense political interest, and once politics irrupt into the comparatively peaceful arena of economics the voice of reason is drowned in a shrill babel of political cries. Consequently the most fantastic and staggering arguments are advanced and the real point of issue is lost sight of under a multitude of irrelevancies.

There is therefore some need for a dispassionate statement of the issue, approaching it as what really is, namely an economic problem and not a mere bone of political contention.

General Principles.—Firstly then, to clear our minds, let us start with a plain and obvious platitude. Namely, that the prosperity of a country depends on the sum of its natural advantages and its human efficiency. And that it is not in the power of the Government of any country to increase its prosperity by altering the value of its monetary unit. But that, on the contrary, attempts to force the monetary unit from its natural level will cause injury to trade and will arbitrarily and unfairly affect all outstanding contractual obligations.

The natural level is in normal times the existing level, i.e., that to which prices are already adjusted.

Should the monetary unit be forced to too high a level; should, in other words, exchange be fixed above the price level, all producing industries will be hampered, exports will be checked and debtors will find their burden increased. Consumers and creditors on the other hand will benefit and imports will be encouraged.

Should exchange be unduly lowered, the contrary result will follow. Producing industries will be helped, exports will rise and debtors will benefit, while consumers and creditors will lose and imports will diminish.

In short from fixing too high an exchange the community benefits as a consumer and loses as a producer and vice versa. These gains and losses are not permanent but continue until prices and wages are adjusted to the new level, which then becomes the natural level. The period of adjustment however is necessarily one of difficulty and hardship, and the machinery of industry is to some extent thrown out of gear. Therefore the exchange ratio of the monetary unit, i.e., its value in terms of gold, should only be altered when circumstances make it unavoidable, as the resulting fluctuations are a net loss to the community.

Agriculture.—The loss caused by fixing the unit at too high a level is familiar from the literature of the Bombay Currency League. It is a fact that if rupee exchange be fixed above the "natural" rate, nearly all forms of Indian industry will suffer and though relief will come in time from the adjustment of prices to the new level, considerable injury may have been done in the meantime. Among the industries exposed to danger from an unnaturally high rupee is the greatest of all Indian industries—Agriculture. For, as most of the principal Indian crops compete in the world's markets, the prices of Indian produce are governed by world gold prices and obviously a grower who sells cotton or rice to the value of £1 gold is worse off, until price adjustment is attained, if this is exchangeable into only $13\frac{1}{3}$ rupees than if he can obtain 15 rupees for it. If therefore 15 rupees to the pound is the natural rate, then the grower is robbed of a share of his reasonable dues but if $13\frac{1}{3}$ rupees is the natural rate then, though his receipts in rupees may be lower, his position is the same as though he had received 15 rupees when that was the natural rate.

The damage done by an unnaturally high rupee therefore needs no demonstration. It is patent to all. What is perhaps less understood is the harmful effect of an unnaturally low exchange. Sir Purshottamdas and other economists, believing that the Indian price adjustment is at about 1s. 4d., have argued that at 1s. 6d. the agriculturist loses $12\frac{1}{2}$ per cent. and, granting the correctness of their hypothesis, he undoubtedly does so. This is so striking a fact that other propagandists are apt to leave out the qualifying clause and lay down as a general principle of exchange that a low rate in itself is a gain. From which it would follow that—the adjustment of the price level apart—an advantage is to be obtained from the very fact of reducing the exchange value of the monetary unit. In other words that a Government can increase the prosperity of a country by tampering with its currency—which of course is absurd.

Lowering Exchange.—As, however, there is a good deal of self delusion on this point we will consider the effect of a sharp drop in exchange and, to be as uncontroversial as possible, will take an imaginary case. Let us say Germany before the war. The German mark was a gold-based coin exchanging at a rate of roughly 20 to 1 with the gold sovereign and this value had been stable for 50 years. She was doing a large export trade and was competing all over the world with Great Britain, the United States and other manufacturing nations.

Now let us suppose that the Government had attempted to foster German industry by reducing the gold value of the mark by 1|10th, giving it a value of 18 shillings in place of 20 shillings as before. Then what would happen?

The German manufacturer having hitherto been able to market articles at 20 marks, competing with British articles at 20 shillings, now finds that while his producing cost is unchanged he can sell at 18 shillings. Consequently he undercuts his competitors and there is a boom in the export trade. But meantime the drop in the exchange value of the mark is having its effect on internal prices. In the first place all imported articles will cost their old prices plus the percentage by which the mark has fallen. Secondly all Home-made articles in which there is a considerable export trade will also rise immediately because the advantageous exchange has made the export trade profitable and consequently prices for internal sales will have to rise to compete with export sales. There will therefore be an immediate rise in many prices which will gradually spread and will very quickly affect wages and less quickly rates, taxes, transport charges, entertainment charges and finally—salaries. When the chain is complete the manufacturer who used to manufacture for 20 marks, and compete with the British article at 20 shillings, will now manufacture at 22 marks odd and still compete on the same terms as before.

So that the dropping of the exchange has secured him no permanent advantage, but has enabled him for a short period to make unnatural profits at the direct expense of his workmen and salaried employees and the indirect expense of the general public. If that were all, the harm done would not be serious, but unhappily the adjustment of prices, though inevitable is by no means peaceful and automatic. Strikes and lock-outs would occur during the process and, by reason of certain trades being temporarily favoured at the expense of others, there would be some fluctuation of labour between one industry and another. In short, the whole economic fabric would receive a jolt from which it would take some time to settle down. At the end some would have gained—others lost. The Government would have robbed Peter to pay Paul.

The Case of India.—While the impossibility of paying Paul without at the same time robbing Peter is probably admitted by everybody, one hears the argument that this does not apply in India. Or rather that in the circumstances existing in India it is worth paying a deserving Paul even at the expense of undeserving Peter. The argument in its crudest form is that the lower exchange is a benefit to the agriculturist as such and a loss to the man who wishes to buy a Rolls-Royce and a diamond tiara. So indeed it is. But the basic fact remains that if the agriculturist and producers generally are to obtain any benefit from lower exchange, it can only be by a rise in the price of goods of all kinds, Home-made as well as foreign—of which Rolls-Royces and diamonds form a negligible fraction.

Take for instance wheat. The argument of the Currency League is that the price of wheat being controlled by world gold prices, the Indian grower, in obtaining the same gold price, will receive roughly 12½ per cent. more in rupees. And so he will. But so also will the price of wheat rise internally because the price at which it just pays to export is the level to which the Indian price will be adjusted. The same will apply to all exported crops and even in the case of crops which are never exported a similar result will arrive—though less quickly—by the greater profit obtainable on growing exportable crops and the tendency therefore, where there is an option, for exportable crops to replace others and thus reduce their supply.

Again with cotton cloth. It is claimed, and rightly claimed that a rate of 1s. 4d. would be of benefit to the Indian Cotton Mills. Not of course a benefit to the extent of 12½ per cent. because raw material and stores will rise proportionately but certainly a benefit so far as concerns their payments for wages and salaries.

This, however, can only be secured by raising the price of cloth by $12\frac{1}{2}$ per cent. and will last until wages and salaries are adjusted to the new level. This may certainly prove to be a lengthy period and during such period the companies gain and the workers lose, but there will be no permanent gain except in one or two relatively unimportant points such as rent, debenture interest, preference dividends, etc., and in any other cases where the company's outlay is fixed in terms of rupees.

In short, the dropping of exchange below the natural level is a stimulant to exporting industries and its effect, like the effect of other stimulants, will be only temporary and may indeed be followed by a period of reaction.

Debtors and Creditors.—Another argument against the alteration of the rate of exchange is that it is an arbitrary and unfair interference between Debtor and Creditor. Debts, being contracted in terms of the monetary unit, any rise or fall in the real value of the monetary unit presses unfairly on debtor or creditor as the case may be. When the debt becomes repayable it is greater or less in real value than when it was contracted.

But this argument carries no weight in the present case. So far as concerns pre-war debts it is true that at 1s. 6d. exchange the debtor has to repay rupees worth 8 grains of gold, whereas he only borrowed rupees worth 7 grains. But as the 8-grain rupee has a purchasing power far below that of the 7-grain rupee before 1914 there is no hardship for the debtor. On the contrary the debtor has gained substantially by the rise in prices (i.e., drop in the purchasing power of gold) and any increase in the gold value of the rupee merely goes some way towards reducing the gain and compensating the creditor.

As to post-war debts, it depends in each case on what the gold value of the rupee was when the debt was contracted and it is not possible to find any rate of exchange that will be fair and equitable for all such borrowings. Striking an average, probably 1s. 4d. would be slightly fairer than 1s. 6d. but that is all that can be safely said.

Indian and European Interests.—The exchange problem is sometimes represented as a conflict between Indian and European interests.

It is assumed that a high exchange is beneficial to Europeans and particularly that it amounts to a bonus on British capital invested in India. Undoubtedly it helps persons with fixed incomes—whether European or Indian—and, in the case of the European, enables him to remit his personal savings to Europe on more favourable terms. But the suggestion that it is a bonus to foreign capitalists is not only unfounded but is directly contradicted by the main argument of the advocates of the lower rate, viz., that with the rupee at 1s. 4d. India will obtain 12½ per cent. more for its exports.

Assume that a British firm deals in jute and handles on an average 2½ per cent. of the total jute crop.

The prices of jute will *ex hypothesi* be 12½ per cent. higher with 1s. 4d. than with 1s. 6d. Therefore the firm's turnover in rupees will be increased to that extent and so will profits on their business. So that though, if a member of the firm wishes to remit £1,000 to England, it will cost him Rs. 15,000 instead of Rs. 13,333, he will earn the larger figure just as easily as he would have earned the smaller to-day.

To put it in a nutshell, the gold earning power of capital will remain the same whatever the rate of exchange, except that if there were anything in the theory that a return to 1s. 4d. would mean enhanced prosperity foreign capital would share in the resultant gain. The only foreign capitalists who will definitely gain will be those who have investments of a fixed yield such as preference shares, debentures and government securities, but such investments must bear a very small proportion to the total of foreign capital invested in Indian enterprises.

We therefore come back to the point from which we set out, namely that it is impossible to say that one rate is right and the other wrong, without coming to a definite decision on the question of the adjustment of prices. In any case, provided Government has sufficient resources to maintain the rupee at the selected level—and that is of course, of the first importance—the prosperity of India will as before depend on her natural resources and her human efficiency and will be only temporarily affected if the rate chosen is either above or below the existing price level.