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INDIAN CURRENCY & FINANCE

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PREFACE

This book is complementary to my treatise on Money. It contains the complex history of Indian Currency in brief, and gives an uptodate information about it. Appendix 'A' deals with English Currency System with which all students of Currency must be familiar in order to understand its impact on currency in other countries. The book as it is covers entire syllabus of the subject prescribed in B. A. and B. Com. examinations of various universities. The author is confident that it would meet the need of the public in general and students in particular.

In the end, he owes apology to the readers for the mistakes which have crept in during the course of printing due to the inadvertence of the press. They have, however, been corrected by an errata at the end.

K. N. GARG

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CHAPTER I

PRE-BRITISH CURRENCY*

Currency in India, as currency elsewhere, has passed through various stages. Among primitive peoples there was trade by barter. Later on, a number of articles had come into use as media of exchange, and the cow amongst them stood as the highest unit. At the lower end of the scale, for small purchases, stood shells, beads, knives and bars of copper and iron. The Cowrie shell, brought from the Maldive islands, remained by far the most prominent even till the outbreak of the Great European War 1914-18. One finds very frequent mention made of *suvarna* (gold) in the Sanskrit books. From 518 B. C. to about 350 B. C., when an Indian province or satrapy was included in the Achaemenid Empire of Persia, 360 talents in gold dust was, Herodotus tells us, paid annually as tribute from the province into the treasury of the Great King. Coming to the development of coinage, it must be said that this also passed through the same stages as in Europe.

1. Currency during Hindu period

Certain small ingots of silver, whose only mark is three circular dots, represent probably the earliest form. Next, in order, are some heavy bent bars of silver with devices stamped out with a punch on one side. These and other indigenous coins remained in circulation in Southern India till the end of the fourteenth century. But the coins in Northern India, under foreign influences brought about by a series of foreign invasions underwent many and varied modifications. First of all, there was an imitation from Greek coinage, then from Parthian, and then from Roman through Yuch-chis. Gupta coins of Gupta Dynasty which lasted from about A. D. 320 to 480, were perhaps the best. This period synchronises with a great revival of Hinduism.

*From *The Coics of India*—C. J. Brown, page 14.

and along with it of literature, arts and sciences. The Huns introduced the Sassanian type. The Sassanians, either belonged to Persia or owed allegiance to the Persians. Rajput coins, which followed, did not vary much from Gupta coins.

2. Currency during Mohammedan period

The conquests of Muhammad Ghori wrought a revolution. The engraving of images was forbidden by the Faith. Hence, both obverse and reverse were devoted to the inscription which set forth the King's name along with his titles, the date in the Hijri era, the place of mint and the profession of Faith ; there is no God but Allah, and Muhammad is the prophet of Allah. During the Hindu period, coins usually in circulation consisted of gold copper and bullion. Silver was almost absent. But during this period, it reappeared because of the opening of commercial relations with Central Asia, and finally drove gold. Besides, the employment of billon for smaller money a. this period was made impossible as the mixture of silver and copper in varying proportions had begun to be unworkable. Till then, it was not known that they form a homogeneous alloy only when mixed in the ratios of 71'89 and 28.11 respectively. So gradually, there remained in circulation in course of time in Northern India only silver and copper coins. Rupee was firmly established by Sher Shah.

A passing reference may, at this stage, be also made of Muhammad Bin Tughlaq. Thomas calls him as 'The Prince of Moneyers'. His coins were the best of all made till then. Next, there was a large output of gold : the issues were of all denominations ; the inscriptions were varied and experiments several—the most striking that of the forced currency which all students of history know and for which they have given him the title of 'the mad', though there is no madness in introducing iron currency when paper currency can be issued without much adverse comment. The art of coinage, however, being at an imperfect stage at the time, forgeries were farbricated with ease, and as the historians say 'The house of every Hindu was turned into a mint'. The Sultan had, thereupon, to withdraw the issue and redeem genuine and forged coins alike at his own cost.

The reign of the first two Moghul Kings, *viz.*, Zahir-uddin Babar and Humayun was nothing more than a kind of military occupation, and hence their silver *Shahrukhis* or *dirhams* were issued only as occasion warranted. Sher Shah, who after the expulsion of Humayun, ruled the country ably for a brief period of five years showed originality in all spheres. His innovations in coinage lay in establishing the rupee and the *dam.* Rupee,a silver coin of 178 grains, and *dam*, a copper coin of 33 grains were issued by him from at least twenty-three places. There were half, quarter, eight and sixteenth parts of *dam* as well. Akbar and Jahangir expressed their artistic tastes in their issues which were made of both gold and silver varying from 2000 tolas to a few grains in weight. Big pieces were not current; they were presented by the King. Akbar's and Jahangir's love of gold possessed them the most. Their standard gold coin was the Muhar of about 170 to 175 grains. There were half and quarter Muhars, and some smaller pieces as well. The rupee adopted from Sher Shah's currency, weighed 178 grains. Its halves, quarters, eighths and sixteenths were also struck. Special coins were issued for special purposes. Gold and silver *nisars* were often issued by Jahangir, Shahjahan, Aurangzeb, Jahandar and Farrukhshiyar for giving presents. Besides, Jahangir issued *Nure Afshan* "Light scattering" and *khaire qabul* 'May these alms be accepted.' Aurangzeb and Farrukhshiyar issued *dirham shahi* for the collection of Jaziya. The copper coins of the Moghals were based on those of Sher Shah's. The half-dam was called the *nisfi* ; the quarter, the *damra* ; the eighth of a dam, the *damri.* Akbar issued silver tankahs of 644 grains and their halves, quarters, one-eighths and one-sixteenths, and four, two and one tanki pieces as well.

All these coins were highly ornate ; Jahangir's most of all. In the beginning there was Kalima on the obverse, and the name and title on the reverse. But later on, fine couplets were added to them. Sometimes, one couplet was used by one mint, at others by a group and still at others by all. These changed so often. Then followed the Emperor's name on the obverse, and the month, date and mint name on the reverse.

For some years, Jahangir issued square and round shapes alternately every year. In his later coins there are pictorial representations of the signs of the Zodaic as well. In some coins, he is shown seated cross-legged with a wine-cup in his hand. These were presented by the King to the ladies of his court.

3. Currency during the period of chaos that followed the break-up of the Moghal Empire

Currency had fallen in confusion during the period of chaos that followed the break-up of the Moghal Empire. Independent kings with their territories spreading over only one or more of districts issued their independent coins. The result was that at the beginning of the nineteenth century there were no less than 994 different gold and silver coins, old and new, passing as current in the country. Many of them were debased, and there was nothing to distinguish the genuine from the spurious. The English factories coined the South Indian pagodas and copper and silver coins in European style and also reproduced rupees of the Moghals In 1742 the emperor Muhammad Shah granted the East India Company the right to coin Arkat rupees. Gradually, it assumed control of all mints within its expanding territories. This was also done by the Marhattas when they were assuming power after the fall of the Moghul Empire. Numerous Rajput states had copied the imperial coinage in their mints. The Nizams of Hyderabad had done it in their own territories, and the Rohillas of Rohilkhand in Najibabad, Moradabad, Bareilly and Saharanpur. First of all, this was done under the name of the Moghal Emperor with some distinctive mark showing the authority of the respective issuer. But in course of time, the name of the emperor was dropped. Haidar Ali struck pagodas and *fanams*. Tipu continued these. In addition he ordered the coinage of muhars and half muhars, silver double and full rupee with its half quarter, one-eighth, one-sixteenth and thirty second parts, and copper pieces of 40, 20, 5 and 2½ cash. The 40 cash piece weighed 340 grains. The Sikh league, known as the Khalsa, formed with a view to safeguard the country from the repeated invasion of Ahmad Shah, had assumed the right of coinage in 1764. For about 12 years, it struck Gobindshahi rupee at Lahore. Nanakshahi rupee was struck at Amritsar. During the reign of Ranjit Singh, coins were struck at several places, notably Lahore, Amritsar, Multan, Kashmir, Peshawar and Jhang. The Wazirs of Oudh issued Machhlidar rupees from Lucknow from 1784 till 1818. In 1818 Lord Hastings persuaded the then Wazir to assume the title of king and from that year till the deportation of Wajid Ali Shah 1856, silver and gold were struck in this part of the country to the Moghul standard.

SUMMARY

1. Certain small ingots of silver with three circular dots in the beginning, and then some heavy bent bars of silver with devices stamped out with a punch on one side were the indigenous coins in India In Northern India, which was subjected to a series of foreign invasions, they were later on modified from foreign influences.

2. During Mohammedan period, there was a revolution in coinage. Muhammed Bin Tughlaq is famous for his various experiments, and specially that of a forced currency. Akbar's and Jahangir's coins were the most ornate. Rupee had been established by Sher Shah.

3 Currency had fallen in confusion after the break-up of the Moghul Empire. There were 994 different gold and silver coins passing as current in the beginning of the nineteenth century. Each king had begun to issue his own coins.

TFST QUESTIONS

1. Show that the conquests of Mohammed Ghori wrought a revolution in the art of coinage in this country.

2. Give a short account of the Moghul coinage. Is rupee a reproduction of the same ?

3. Give a short account of the currency after the break-up of the Moghul Empire and before its revival by the British.

CHAPTER II

CURRENCY BEFORE 1835

We have already seen that both gold and silver coins were in circulation in India, when the East India Company came to assume power. But there was *never any fixed legal relation between them*. First of all, the Company tried to maintain *status quo*. But this could not be possible for long. There was *difficulty experienced in carrying on the internal trade.* The exchange value of the coins was determined by their weight and fineness. In making even moderate payments the parties were obliged to call in a shroff 'to declare the value of each coin, or else everybody had to keep in his pocket a balance and a touch-stone. Then, *it tried to improve currency by taking coinage from the Moghul Kings in its own hands.* It also tried to *establish a bimetallism* by fixing a legal ratio between its gold and silver coins, but this could not prove successful even in the least. The English Governor would fix one rate of exchange between them, the French Governor another, the Nawab of Arcot the third, and the Nizam of Hyderabad the fourth, and there was *the operation of Gresham's law.* The legal ratio had to be changed according as there was need to attract one or the other metal.

1. Despatch of 1806

About this time Lord Liverpool published in England his famous *Treatise on the Coins of the Realm.* This enunciated the principle of monometallism. The Directors of the East India Company, seeking a way out of the currency trouble in India, were much influenced by it, and in their despatch on the 25th of April, 1806, to the Governments of Bengal and Madras wrote that 'they were fully satisfied with the propriety of the *silver rupee being the principal measure of value and the money of account.' Nor was it their intention to drive gold out of circulation* from places where it was the general measure of value, and they took care to specify it. They even proposed that a gold rupee of the same weight and fineness as the silver rupee should be coined, but that no fixed legal ratio should exist between them.

The recommendations of the Directors as contained in the above despatch, of course, allowed discretion to the Indian authorities as regards the time and manner giving effect to them, and hence, were not acted upon immediately.

2. Steps taken between 1818 and 1835

The various Presidencies under the East India Company took steps, in accordance with the provisions of the despatch of 1806, in different years, Madras being the first. *In 1818, the silver rupee of 180 grains, 11/12th fine, was substituted for the gold pagoda* which had been a standard coin there for long. The coinage of the latter was stopped, but it could not be altogether given up. In fact, this was not possible. The people had been associated with it for thousands of years. It continued to be paid and received by all the public offices at such rates as were proclaimed from time to time.

In 1823, Bombay rupee was made identical with the Madras rupee. The final step was, however, taken in 1835 by the Coinage Act of that year.

3. The Coinage Act of 1835

The Coinage Act of 1835 placed India on silver monometallism. Its essentials were —(1) The silver rupee of the weight of 180 grains troy (165 pure and 15 alloy or of 11/12th fineness) was declared to be a standard coin and unlimited legal tender *throughout British India*. Provisions were made for the issue of its half, quarter and one-eighth parts as well. They were to contain silver of the same fineness and proportionate weight as rupee. (2) Gold was completely *demonetised* and igold coins did not at all remain legal tender in any part of the Brtish territories in India. (3) *Gold was, however, allowed to be coined freely*. Mints remained open to the public for the free coinage of both gold and silver. Gold mohurs of the same weight and fineness as the silver rupee could be issued from the mints, and they were meant to circulate at Rs. 15. Gold coins of Rs. 5, 10, and 30 denominations could also be minted.

SUMMARY

1. East India Company tried to improve currency by taking coinage from the Moghul kings in its own hands. It also made attempts to establish bimetallism. The Directors recommended silver monometallism for the country in their despatch of 1806.

2. In 1818, rupee was made legal tender in Madras, in 1823, in Bombay, and in 1835 throughout British India.

3 The Coinage Act of 1835 made rupee standard coin and legal tender throughout British territories in India. It demonetised gold, but allowed its coinage. Mints were open to the public for the free coinage of both silver and gold

TEST QUESTION

1. Give a brief history of the currency system in India in the earlier years of the nineteenth century. What were the peculiarities of the Coinage Act of 1835 ?

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CHAPTER III

CURRENCY FROM 1835-93

From 1835 to 1893 India had a silver standard. *Mints were open to free coinage of silver.* The face value of the rupee was equal to its intrinsic value, *i.e.*, the value of the rupee against gold or commodities was equal to the value of silver contained in it. This period of the history of Indian currency is very constructive. *First of all*, a change in the value of precious metals--silver and gold—brought with it great difficulties in maintaining the stability of the rupee. *Secondly*, with a view to doing away with these difficulties, a number of experiments were suggested and tried. We shall come up to these presently.

1. Attempts to introduce gold in circulation (1835-74)

We know that gold had been completely demonetised by the Coinage Act of 1835, though mints had been left open to the public for its free coinage. Gold mohurs and Rs. 30, 10. and 5 pieces though coined had ceased to be legal tender currency. It is difficult to understand why gold coins struck under the Act were not to be legal tender. Indians had been for long using gold in circulation, and they continued to demand it even after the passing of the 1835 Act.

The proclamation of 1814. In pursuance of the people's demand, a proclamation issued in 1841 authorised *receipt of gold coins* in public treasuries in payment of public dues at their face value. This meant that the rate of exchange between gold and silver was fixed at 1 : 15, as the gold mohur and the silver rupee were of identical weight and finesness. This satisfied the people though they did not tender gold coins in any considerable quantity. It may be mentioned that *the people could not demand gold coins from the treasuries.* Nor could they enforce payment in these between their ownselves.

Withdrawal of the privilege given in 1841 (1853). During 1848-51 gold mines were discovered in California and Australia. The result was a fall in the value of gold relatively to the silver. This led the people to pay the treasuries in gold coins which were accepted there at the old rate. Gold began to flow to the treasuries in large quantities and the Government lost by accepting it at a rate higher than the market rate. Hence, *a Notification was issued on 25th December, 1852,* by which the privilege given in 1841 was withdrawn and it was declared that, on or after 1st January, 1853, 'no gold coin will be received on account of payments due, or in any way to be made, to the Government in any public treasury within the territories of the East India Company.'

This had the effect of driving out of circulation and turning into hoard £120 million worth of gold coins, as H. D. Macleod estimates in his book on Indian currency.

Gold continued to be received into the mint for coinage under the Act of 1835.

Revival of the privilege in 1864. There was again an agitation in favour of gold. Almost all the Finance Members of the Government of India championed its cause. In 1864, the Chambers of Commerce of Bengal, Bombay and Madras sent memorials to the Government of India favouring a gold currency. As a result, *the Governmeat agreed to receive and pay when convenient* sovereigns and half-sovereigns minted at any authorised mint in England or Australia at the rate of Rs. 10 and Rs. 5 respectively. But they were not to be legal tender. It may, however, be remarked that gold coins were parted at these rates neither by the Government nor by the people.

Mansfield Commission, 1866. The agitation in favour of a gold currency in active circulation went on and the Government had to appoint the Mansfield Commission, which was the first of the Committees and Commissions which have sat from time to time to deliberate upon the problems of Indian currency. ***It concluded that :—***

(1) Gold coins of Rs. 15, Rs. 10 and Rs. 5 should be issued

as these would find more favour in the eyes of the people than notes[1] of like value ;

(2) The introduction of gold coins would pave the way to the establishment of the currency notes ;

(3) The currency should consist of gold coins, silver coins and paper notes ;

(4) Some of the notes should be made universal[2] ; and

(5) The Government should recommend after some time to the Secretary of State the making of gold coins legal tender in India in pursuance of the general wish of the country.

But nothing substantial resulted from these conclusions and the experiment of the limited introduction of gold into circulation by keeping open the offer to receive and pay at convenience sovereigns and half-sovereigns at Rs. 10 and Rs. 5 respectively continued to be carried on. In 1868, the rate for receipt of sovereigns and half-sovereigns was raised from Rs. 10 and Rs. 5 to Rs. 10·8 and Rs. 5·4 respectively, as the old rate was sometimes below their average market value.

Sir Richard Temple Episode. In 1872, Sir Richard Temple, the then Finance Member, put before the Government of India a scheme for making gold coins legal tender in the country. The following extracts taken from his minutes represent his honest opinion.

'On the whole, it seems clear that while in all branches of administration, we endeavour to give to India the best of everything so far as we can, yet, in respect to metallic currency, we deliberately withhold from her the first rate article and afford her a second rate one.'

Sir Richard Temple resigned in April 1874, and in May following, the Government of India decided finally against the recognition of gold as a standard of value for the country.

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1 Notes had been begun to be issued by the Government of India since 1862.

2 This was not done till 1909.

2. The Indian Coinage Act of 1870

In 1870, the Indian Coinage Act was passed *consolidating* all previous legislation on the subject of coinage in British India.

3. Fall in the gold price of silver (1874-1893)

By 1874, a great change had begun in the monetary status of silver. Commencing from 1871, a number of countries, *viz.*, Germany, Denmark, Sweden, Norway and Holland had given up silver standard and adopted gold standard in its stead. Besides, several other countries, *viz.*, France, Belgium, Italy and Switzerland that had joined the Latin Monetary Union, beginning to find it difficult to maintain a pucca bimetallic standard because of the operation of the Gresham's law, due to which over-rated metal (silver) had begun to be poured in them, and had suspended the coinage of silver The effect of these two events was the beginning of a fall in the price of silver. It was further accentuated in the following years due to a number of causes. For the sake of convenience, these may be divided into (*i*) those on the side of silver, and (*ii*) those on the side of gold.

Causes of the fall in the gold price of silver

(*i*) In the early years of the fall *much redundant silver coinage was coming to the market* from those countries which had given up silver standard and adopted gold standard in its stead.

(*ii*) *The world production of silver went on increasing.* Within a course of about fifteen years from 1875, it rose from about 78 million ounces to about 144 million ounces. This was the result of (*a*) discovery of a number of silver mines in Mexico and other silver producing countries, (*b*) the invention of the Pattinson process for separating silver from lead, which made it profitable to extract comparatively small quantities of silver which in previous times would have been left in the lead as sent to market. A number of lead roofs were taken off the buildings in Europe and were replaced with new lead, merely in order to extract the silver from the old lead.

(*iii*) The cost of production of silver had gone down over and above the fact mentioned in (*ii*) (*b*) due to the ***introduction of a new mining machine.***

(*iv*) On the other hand, *the demand for silver was reduced.* A number of countries had given up silver standard and several others though continuing to have bimetallism had suspended the coinage of silver. There were only two countries, *viz*. China and India, left on silver standard at that time. Demand from them remained, but this was not sufficient to support the price.

On the gold side the causes were as follows :—

(1) *The richest beds of gold fields had been exhausted.* There had not been any discovery of new mines after those of the Australian and Californian. South African and Klondyke gold-fields were discovered at a much later period.

(2) *Demand for gold had been rising.* A number of countries had adopted gold standard. Besides, trade was expanding rapidly, and this was giving rise to a greater and greater demand for money.

Attempts to arrest the fall in the price of silver Several attempts were made to arrest the fall in the price of silver. The most important of these were ***connected with the establishment of international bimetallism.*** For this purpose, four great International Monetary Conferences were held between the years 1867 - 1892 :

The First International Monetary Conference. The first International Monetary Conference was held at Paris in 1867. This was attended by the representatives of 18 principal countries of Europe and the United States of America. It was a scramble for gold. The Conference declared gold standard to be the only standard suited to international money. But it opposed the adoption of gold standard by new countries vehemently.

The Second International Monetary Conference. This Conference was held in August, 1878, at the instance of the United States of America after the passing of the Aland Bllison Act (of which we shall take a notice later on) by it. It was proposed therein that a common ratio should be adopted between gold and silver by the principal nations of the world to enable the establishment of an international bimetallism. But there was no agreement as gold using countries did not want (i) to give up gold standard and adopt bimetallism and to allow gold to be introduced in the currency system of silver using countries in any form.

The Third International Monetary Conference. This Conference met in July , 1881, at the instance of France and the United States of America with the same proposal to consider as before, *viz*, the introduction of international bimetallism. One delegate was sent by England , but on the clear understanding that he would oppose bimetallism. The purpose of sending him was only to give information required by the Conference. Two delegates were sent by the Government of India as well , but it was understood that she was not committed to the principle of bimetallic system in India.

In 1886 , the Government of India wrote to the Secretary of State favouring international bimetallism but without any effect .

The Fourth International Monetary Conference. This Conference was called by the President of the United States of America in June 1892 at Brussels. The proposal before it was not the introduction of bimetallism, but to settle "what measures, if any, can be taken to increase the use of silver in the currency system of nations." But there was no agreement even with regard to this point. The Government of India evinced a great interest this time.

The Bland Allison Act. This Act was passed in the United States of America a few months before the calling up by it the second International Monetary Conference of 1878. Its purpose was to restore[1] silver as legal tender. The Secretary of the Treasury was to purchase and coin each month not less than

1 It had been dethroned as money in 1873.

2 million dollars and not more than 4 million worth of silver into standard silver dollars. The purchases were made, but the fall in the price of silver could not be arrested.

The Sherman Act. This Act was passed by the Government of the United States of America in 1890, and required the purchase of not less than 54 million ounces of silver by it annually. It was 35 to 43 per cent of the world's production and thrice of what was bought under the Bland Allison Act. There was, no doubt, a temporary rise in the price of silver, but this could not help much. The representatives of the United States had declared at the fourth International Monetary Conference held in 1892 at Brussels that their Government might be inclined to repeal the Sherman Act as a result of the failures of the conference to arrive at an agreement with regard to the measures to be taken to increase the use of silver in the currency system of nations. On November 1st, 1893, the silver purchase clause of the Act was repealed accordingly, and the artificial demand having been thus put off, the price of silver fell further in consequence.

The Gold and Silver Commission. A Royal Commission, *viz.*, the Gold and Silver Commission, sat in England in 1886 to enquire into the changes that were taking place at that time in the relative values of the precious metals but without any practical results. Half of the members wrote against bimetallism and half favoured it.

The part played by the Government of India. All through the years 1874-93, the Government of India had been feeling acute distress because of the fall in the price of silver, and hence it could not sit silently. *First of all*, there was the scheme of Col. J. T. Smith, Master of the Mint at Madras, for the adoption of gold currency. *Next*, there was the scheme of the Government of India itself. But they were rejected by the Secretary of State for India. *Thirdly* it expressed itself in favour of bimetallism. But this as well did not receive the support of the Secretary of State. *Finally*, it sent a despactch to the Secretary of State in June 1892 containing certain proposals to be accepted by the latter on the failure of the Brussels Conference. These proposals were:—

(1) that the Mints in India be closed to free coinage of silver, and

(2) that arrangements be made for the introduction of a gold standard (A fresh scheme was put this time as well).

A further statement was made by the Government in its telegram to the Secretary of State on January 22, 1893, which amongst other things recommended the rate to be established between rupee and gold at 1s. 6d.

4. Herschell Commission, 1893

This Commission was appointed by the Secretary of State for India to examine the proposals contained in the Government of India despatch of 1892 and statement in the telegram to the Secretary of State on January 22, 1893. *First of all*, the Commission examined the effects of the fall in the gold price of silver. The mint in India being open to the free coinage of silver at that time, there was a corresponding fall in the exchange rate of the rupee with a fall in the price of silver. This is evident from the following:—

Year	Price or Silver Per ounce in (d.)	Rate of exchange s. d.
1871—72	$60\frac{1}{2}$	$1'11\frac{1}{8}$
1875—76	$56\frac{3}{4}$	$1'9\frac{5}{8}$
1879—80	$51\frac{1}{4}$	1'8
1888—89	$42\frac{7}{8}$	$1'4\frac{3}{8}$
1890—91	$47\frac{11}{16}$	$1'6\frac{1}{8}$
1891—92	45	$1'4\frac{3}{4}$
1892—93	39	1'3
1893—94	$35\frac{5}{16}$	$1'2\frac{1}{2}$
1894—95	$28\frac{15}{16}$	$1'1\frac{7}{8}$
1895—96	30	$1'1\frac{1}{2}$
1896—97	$30\frac{3}{4}$	$1'2\frac{1}{2}$
1897—98	$27\frac{9}{16}$	$1'3\frac{3}{8}$
1898—99	27	1'4

1. *Financial Difficulties Government of India* (1) *Home charges.* Each year, the Government of India had to remit to the Secretary of State and High Commissioner for India a huge sum in connection with what were known as home charges which were payments for loans contracted in England for Indian railways and irrigation purchases of bar silver for Indian Silver currency, stores purchased, pensions and furlough allowances, expenses of the High Commissioners' office, etc. In 1892-93, this amounted to £16,532,215,[4] and the fall in the value of silver and hence the exchange rate of the rupee meant that more and more rupees were required to remit every £ than previously. And this resulted in the conversion of a surplus budget into a deficit budget. It was also feared that the price of silver would still go down and hence entail difficulties. The means available for making up the deficit were either increase of taxation or curtailment of expenses. But none of these alternatives was possible, as the taxable capacity of the people had been reached and economies could not be made in the expenses.

(2) *Fall in customs receipts.* Falling exchanges mean curtailment in imports and hence in customs receipts. The Government was hard hit by this.

(3) *Demand of government employees for a higher salary.* Rise in prices led to a demand of the employees, both government and private, for a higher salary. European officials began to put forward claims for compensation for the loss which they sustained owing to the fall in exchange. They received their salaries in rupees, and to remit a given amount in terms of pounds to England for the support of their families, they had to spend a larger and larger portion of their income than before.

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4 In 1936-37 it was £41 million ; in 1937-38 £37 million ; in 1938-39, £36 million ; in 1939-40. £20 million ; in 1940-41, £23 million ; in 1941-42 £25 million ; approximately.

2. *Difficulties of people (1) Effect of the financial difficulties of the government on the people.* As for as the effect of the financial difficulties of the government on the people was concerned, it may be said that this was not, on the whole, detrimental to them. In estimating the burden, it must be borne that it is measured by the quantity of product which it represents. When silver fell and prices rose, the increased burden did not represent a greater quantity of produce which had also been simultaneously rising in value. But adjustment between value of money and prices of commodities takes some time to complete, and during the interval Indian producers, particularly the agriculturists suffered some loss for a short time. No doubt this loss was only temporary.

(2) *Shifting of burden.* The burden of increased taxation consequent upon the government's financial difficulties did not fall uniformly upon all the classes of people. For instance, the burden of those who paid a fixed land revenue under a permanent settlement was lightened, and the increased salt-tax was pressing the people at large. It rendered the burden heavier on those who had suffered rather than gained because of the rise in prices, *i.e.*, the consumers' class of people.

(3) *Harassment by trade uncertainties due to fluctuations.* People do not suffer much either by a rising or a falling rate of exchange and consequently falling or rising prices. What they suffer from is trade uncertainties due to fluctuations. It is always good if commerce is free from all the inconveniences of fluctuations arising from the changes either in exchange rates or prices consequent upon an increase or decrease in the supply of money.

(4) *Alleged stimulation of exports.* The tendency of a falling exchange is to stimulate exports. But this is only temporary. In the long run, an adjustment is brought about by various other factors which are always on the run. In this case, ***there was not even this temporary stimulation*** as is evident from the figures during this period.

(5) *India made to buy depreciating silver.* Silver was losing in value, and people suffered tremendously on account of this, as they had all of their savings and hoards in the metal. The foreigners finding it cheap to export silver in payment of their Indian imports did it. Had the standard been changed to gold, they would have to send gold instead.

(6) *Difficulties of the people because of a general rise in prices.* Great quantities of silver were imported into India to settle the favourable balance of trade, and this silver was very largely converted into rupees, because mints were open to an unlimited coinage of silver. There was thus a considerable increase of rupee circulation, and at the same time some increase of paper currency. The result was an unprecedented rise in prices, specially during the period 1883-97. This' was particularly evident in the prices of foodstuffs, and of other commodities produced and consumed within the country. As a result the consumers as a whole suffered, but the distress was acute in the case of those who had fixed incomes.

(7) *Difficulties of British Officers in employment of India.* British Officers suffered in remittance of money to England for maintenance of their families and children. In addition, they suffered as consumers as well because of a rise in prices.

But it was pointed out by several witnesses before the Herschell Commission that they were not in much difficulty as they were drawing a much higher salary than was required by them. In the next place, the loss in remitting money to England was compensated, to a great extent, by the fall in prices which was taking place in England and other gold using countries.

3. *Effect inflow of foreign capital.* A fluctuating exchange or more particularly a falling exchange *tended to check inflow of foreign capital into India.* Much of it used to come in those days from the London money market and this hesitated to lend money to countries on silver standard specially when there was uncertainly about the rate of interest

and a likelihood of a diminuation of the principal in case it was to be transferred to London.

4. *Effect on Industries.* India did not possess at that time any manufacturing industries worth the name. But she was beginning to have them. This necessitated an import of machines and technical experts *for which more and more money had to be found* as the rate of exchange fell. Besides, whatever industries were being established, they were being established with the help of foreign capital to the import of which as has already been observed, there was a considerable impediment because of the fall in the exchange rates. As far as agriculture is concerned, this as well did not make any progress. We have already noted that there was no stimulus to export.

5. *Effect on trade and commerce.* A fluctuating exchange has a disturbing effect on the growth of trade. *It has a paralysing effect.* We know that exports did not make much headway during this period. This was the case with imports as well. As regards internal trade this too did not obtain any stimulus due to a falling exchange. Prices were all along rising due to the import of silver and consequent increase in the supply of rupees. But the consumers not being well off, there was no improvement in trade. The element of uncertainty created panic in the minds of the businessmen who, in consequence, contracted their business of whatever from it was whether external or internal.

Consideration of the proposals of the Government of India. Though the Government of India proposed to stop the free coinage of silver and to establish gold standard, *it did not want to substitute gold for silver* as the ordinary currency of the country. It was contemplated that in the vast majority of transaction silver would still be used as a medium of exchange as it was in France and U. S. A. The rate for the exchange of rupee with gold was proposed to be fixed at 1s. 6d.

The Commission considered first of all *effects of stopping free coinage of silver*, and in this connection it took up

(1) gold value of uncoined silver, and (2) future relation of uncoined silver to the coined rupee.

Gold value of uncoined gilver. It was found that for sometimes past the whole of the silver imported had been passing through the mints, and this represented one-fourth of the total world production. Hence, in case free coinage of siver was stopped, *there wis bound to be a tremendous fall it the gold value of silver.* Besides, the effect of the stoppage of the demand for silver from India, it was feared, might induce U. S. A. to repeal the Sherman Act. Finally, it could also induce China the only country remaining on silver standard to give up that standard. In such cases, the fall in the gold value of silver, it was pointed out, would be heavier still.

Future relation of uncoined silver to the coined rupee. The stoppage of free coinage of silver at the mints *was bound to raise the value of rupee in terms of silver.* But it was pointed out that a considerable time must past before the price of rupee could be expected to rise. There was a repundant supply of rupee at this time.

Next, the commission considered wheather it was possible *to introduce gold standard without a gold currency and even without a legal convertibility of existing silver currency into gold.* The example of several countries was cited, and it came to the conclusion that *this was possible.*

Finally there was the question of *the rate of exchange.* The Government of India had recommended a rate of 1s.6d. Even if it was to be the existing rate, this was bound to become greater than the value of the silver contained in expected to continue. Hence, whatever the rate of exchange, *it was bound to cause a divergence in the value of rupee and the silver contained it.* Its probable effects were considered and they were expected to be as follows :

(a) *Stimulus in spurious coinage.* It was pointed out that divergence in value of rupee and silver contained in it would give encouragement to spurious coinage. But the commission was of opinion that this had not happened in other countries and there was no reason why it should happen in India. Besides, this could be stopped by severely penalising it.

(*b*) *Fall in the value of hoarded wealth and ornaments.* A vast majority of Indians had their savings in silver bars or ornaments. If mints were closed, there was bound to be a fall in their value.

(*c*) *Conversion of the whole of India's currency into token currency.* It was also pointed out that divergence in the value of rupee and silver contained in it would result in the conversion of the whole of India's currency into token currency. But the Commission opined that there was a good deal of difference between rupees and inconvertible paper money, inasmuch as the expansion of the former would not be so easy as that of the latter.

(*d*) *An indirect increase in taxation.* It was pointed out that a rise in the value of rupee would mean a rise in the burden of taxation. The commission admitted the truth of this statement. But it ruled it out by saving that this was not in the hands of the Government. If price of silver falls, how can the Government be held responsible for it?

(*e*) *Effect on India's trade with other silver using countries specially China.* Effect of closing the mints to free coinage of silver on India's trade with silver using countries specially China, was also considered. But as this trade amounted to about only half the trade with gold-using countries it was regarded better to fix the rates between gold and silver. Besides, *arguments*[5] were advanced which showed that India would not fare worse in this respect as well.

(*f*) *Currency would be rendered unautomatic.* It was also pointed out that by closing the mints to free coinage of standard coins, the currency system of the country

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[5] Inquisitive students may be referred to the Original Report of the Commission.

would be rendered unautomatic. But the commission stated that the people would take gold to the mint and the Government would give them rupees in its stead, and thus the currency system would be made automatic on a gold basis.

Considering the above, the Commission decided to *fix a rate of exchange but not very much higher than the existing one.* The rate of 1*s.* 6*d.* as paoposed by the Government of India was much higher than the existing one and hence that of 1*s.* 4*d.* was considered to be better than this.

Recommendation of the Commission. Having considered the proposals of the Government of India, *the Commission recommended the following:—*

(1) That the mints be closed to free coinage of both silver and gold. Till then they were open to free coinage of the latter as well, though gold coins were not declared legal tender.

(2) That the Government could coin rupees in exchange for gold at a rate of 7·53344 grains troy of fine gold or 1*s.* 4*d.* per rupee.

(3) That gold coins be received at public treasuries at the rate of 1*s.* 4*d.* per rupee.

(4) That rupee coins should continue to be unlimited legal tender.

Evidently, *it did not make any specific provision for the introduction of a gold standard.* But this was contemplated *to be established in future.* It was thought that a transition period was necessary in which the rate of exchange would be brought up to 1*s.* 4*d.*. When this was achieved a gold standard would be established. At least this is what was emphasized by Lord Farrier and Lord Welly. They also thought that a gold reserve would be provided for in the meantime.

SUMMARY

1. India had from 1835-93 silver standard. Several attempts were made during this period as well to introduce gold in circulation specially between 1835-74 The proclamation of 1841 authorised receipt of gold coins in public treasuries at their face value. But they were not to be paid out. This privilege was however, withdrawn by a notification of 1852. In 1864 again, the Government agreed to receive and pay when convenient sovereigns at fixed rates. In the same Mansfield Commission was appointed, but its recommendations could not be given effect to. In 1872 Sir Richard Temple, the then Finance Member, put a scheme for making gold coins legal tender in India, but this as well was not accepted.

2. In 1870, the Indian Coinage Act consolidating the previous Acts was passed.

3. During the period 1874-93, there was a tremendous fall in the value of silver due to a number of causes. Of course several attempts were made to arrest it but all of them proved abortive Among these may be mentioned, the establishment of the four international conferences, passing of the Bland Allison and Sherman Acts by the Government of U. S. A., appointment of Gold and Silver Commission in England and finally the anxiety of the Government of India to do something.

4 Herschell Commission which was appointed to examine and report upon the proposal of the Government of India first of all pointed out the difficulties of the Government and the people, and effects on inflow of foreign capital into the country and on her industries, trade and commerce, as a consequence upon the fall of the value of silver. Then, it gave consideration to the proposal of the Government and in this connection mentioned the effects of stopping the free coinage of silver, and pointed out the possibility of the introduction of gold standard without a gold currency and and even without a legal convertibility of the existing silver currency into gold Finally, it took up also the question of the exchange rate and showed the need of putting it as near, the existing rate as possible. In conclusion, it made also its recommendations which include the closing of the mints to the public for the coinage of silver but keeping them open to the Government for this purpose, the issue by it of rupee coins in exchange for gold at 1s. 4d. rate the acceptance of gold coins by it at public treasuries at this rate, and continuance of the unlimited legal tender characteristic of the rupee.

TEST QUESTIONS

1. What attempts were made to introduce gold in circulation in India between 1835-74 and with what results ?

2. What were the causes of the fall in the value of silver after 1872 ? Mention in this connection the steps taken by the important countries of the world.

3. Examine the effects of the fall in the value of silver after 1872 upon India's trade, industry and state.

4. Detail the circumstances leading to the closing of Indian mints to free coinage of silver and mention the effects of this step. (U. P. Board).

CHAPTER IV

CURRENCY FROM 1893-1898

The period from 1893-98 was a period of transition. The recommendations of the Herschell Commission were accepted and Act VIII of 1893 was passed on June 26 of the same year. Three notifications were also issued in this respect.

1. The coinage act of 1893 and notifications relating thereto

This Act amended the Indian Coinage Act of 1870 and the Indian Paper Currency Act of 1882. It provided for *closing the mints to free coinage of both gold and silver* as recommended by the Herschell Commission. But it allowed *the Goverment to retain the right to coin silver on its own behalf* The notifications issued were :—

(1) Gold coins and gold bullion would be received at the mints in exchange for rupees at the rate of 7.53344 grains troy of fine gold, *i e.* 1s. 4d. per rupee.

(2) Sovereigns and half sovereigns would be received in payment of sums due to government at Rs. 15 and Rs. 7-8-0 respectively.

(3) Currency notes would be issued in exchage for gold coins or bullion[1] at the same rate.

Its inherent defects. The legislation had certain inherent defects.

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[1] Currency notes could be issued against gold in accordance with the Paper Currency Act of 1882 as well. But the amounts of notes thus issued could not be more than 25% of the total metallic reserve.

(1) *First of all*, rupee though unlimited legal tender and principal coin, was incovertible.

(2) *Secondly*, there was no obligation on the part of the Government to pay gold in exchange for rupees though there was no obligation on its part to receive gold in exchange for them.

(3) *Thirdly*, rupee melting point had not been considered. A rise in the value of silver beyond a certain limits was never contemplated.

2. Effect on the rate of exchange

During the years 1893-95, the rate of exchange, contrary to the expectations of the people, continued to fall.

(i) *First of all*, the people thought that the Government would not be able to maintain the value of rupee. The Secretary of State for India sold bills in London on the Government of India, called *Council Bills*, to collect sterling for meeting home charges on behalf of the Government of India. These, at first, *be continued to sell at the market rate* which was much below 1s. 4d. This led the people to believe that the Government could not raise the rate of exchange and caused great inconvenience. But later on, it was decided by Secretary of State that to allay fears, the bills would be sold at the minimum rate of 1s. 4¼d. per rupee. This rate was higher than the market rate then existing, and debtors in England *did not buy bills for sometimes but sent silver to India.* But mints being closed to its free coinage, *this could not continue for long*, and ultimately they had to purchase the bills.

(ii) There had been going on a large coinage of silver for sometimes past, and *the supply of rupee was in for excess of the demand.* The relative scarcity could be felt only in 1899.

(iii) The years 1896 to 98 were bad years for the country. It was *in grip of famine and plague.* Its result was a reduction in the production of commodities, and hence in the need for money.

But the rate of exchange began to rise in 1895 and reached 1s. 4d. in 1898. It may be mentioned here that price of silver continued to fall during the whole of this period.

3. Gold Note Act of 1898

By 1898, shortage of money had begun to felt, and to relieve that stringency an Act (No. 11 of 1898) was passed, empowering the Government of India to direct, by order notified in the Gazette of India, *to issue currency notes in India, again gold received by the Secretary of State for India in London.* This Act was to remain in force for six months, but was further extended for two years by an amending Act of that year. Prior to this, currency notes could be issued only against rupees and gold[2] held in India and rupee securities.

4. Fowler Commission (1898)

When the rate of exchange was near 1s. 4d. another Commission, namely, the Fowler Commission, was appointed to recommend measures which might lead to the establishment of a *satisfactory system of currency in India,* and for securing as for as practicable, *a stable exchange between* that country (India) and the United Kingdom. Early in 1898, the Government of India had addressed the Secretary of State with proposals for securing early relization of a gold standard in India. These involved a very large withdrawl of rupees from circulation. It supposed that rupees were still in excess of the requirements of trade. Together with its proposals, the Government and forwarded two other schemes, one by Mr. Lesley Probyn, and the other by Mr. A. M. Lindsay. A. M. Lindsay's scheme became much famous later on, as it had meant the establishment of a gold exchange standard which was, in course of time established in this country. Mr. Lindsay had proposed that a gold standard reserve should be created in

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[2] Currency notes could be issued against gold held in India in accordance with the notification issued by the Government of India in 1893 to an unlimited extent.

London by means of a loan of £10 million raised by the Secretary of State, and to be deposited with the Bank of England. Sterling drafts were to be sold in India when required at 1s. $3\frac{3}{4}$d., and met out of this fund. As against this, there would be a rupee section of the gold standard reserve kept in India on which council bills would be sold in London at 1s. $4\frac{1}{16}$d. for trade demands when necessary. But the Commission rejected both the schemes.

There were some who recommended restoration of silver standard, but this too was rejected by the Commission.

Recommendations of the Commission. The Commission recommended *a gold standard with gold currency in active circulation* for this country. The reasons advanced for a gold standard were as follows.

(*i*) Fout-fifths of India's trade was with gold standard countries, and importance of gold in foreign trade had been emphasised by Dr. Marshall in the course of his evidence before the Commission. Introduction of gold standard in India was, according to him, like a movement towards bringing the railway gauge on the side branches of the world's railways into unison with the main line.

(*ii*) A gold standard would stimulate inflow of capital in India, which was greatly needed. First ofall, during the busy part of the year, owing to a heavy demand of money for moving the crops the rate of interest generally rose very high. Secondly, capital was needed for bringing about development of large-scale enterprise in India.

(*iii*) A considerable amount of gold worth £2 million has been accumulated in the paper currency reserve within a very short time. When this could be done so soon and in a period of transition, the Commission held that much more could be done in future with the growth of confidence.

(*iv*) The Government of India had publicly announced that they were willing to take steps for the early establishment of a gold standard and a stable exchange. The Commission thought that no time should be lost in doing it, otherwise there would be doubts in the minds of the people, and various rumours would arise which might result in the withdrawal of confidence in India's monetary future and thus jeopardise the country's material interests.

Its arguments for a gold currency in active circulation were as follows :—

(1) A system without a visible gold currency such as recommended by Mr. Lesley Probyn or by Mr. Lindsay would be looked upon by the people of this country with disgust.

(2) An exchange standard would check that flow of capital into India which was so much needed for the development of her resources.

(3) Gold coins were in common circulation in India not long ago and constituted the the principal currency in Madras till 1806. If hoarding did not render a gold ciculation an impossibility in the past, such results could not be envisaged for the future. The Commission thought that people of India might have hoarded in the past, but with the disappearance of the causes that led them to hoard, the habit was sure to be given up.

(4) There was always an inflow of gold into India, because of its tendency to have a favourable balance of trade. The Commission thought that this would make possible accumulation of sufficient gold reserves for monetary purposes.

Other recommendations of the Commission in this connection were as follows :—

(1) British sovereigns be made *legal tender* and current coins in India. *Indian mints be thrown open* to unrestricted coinage of gold on such terms and conditions as govern the three Australian branches of the Royal Mint.

(2) The Government should *continue to give rupees for gold but fresh rupees should not be coined* until the proportion of gold in the currency was found to exceed the public requirements.

(3) Any profits on the coinage of rupees should not be credited to revenue but be *kept in gold as a special reserve* entirely apart from the paper currency reserve and ordinary Treasury balances.

(4) When the Government has accumulated a sufficient gold reserve and so long as gold is available in its Treasury, *it might discharge its obligations in India in gold instead of rupees.* It may be mentioned that the amount of rupee circulation being very large, imposition of an obligation on the Government to convert all rupees into gold would have been a serious liability, and hence this was not recommended by the Commission.

(5) The Government *was obliged to make gold available for export, if exchange showed a tendency to fall below the specie point.* Thus it is clear that while the Government was under obligation to pay gold for external purposes, it was not so for internal purposes.

(6) *The value of rupees was fixed at 1s. 4d., i.e.,* Rs. 15 to a sovereign or 7·53344 grains troy of fine gold per rupee. Reasons for doing so were ; (a) This rate had been steady since January 1898. (b) This had also been recommended by the Herschell Commission and everybody had pinned his faith on it. (c) In 1898-99, at this rate total volume of export trade amounted to Rs. 120 million, a figure which was never attained in the past. (d) Prices and trade had adjusted themselves to this rate.

(7) Rupeee although made token coin *be kept unlimited legal tender.* This had been the position of silver coins in France and U. S. A. as well, where they had not been coined since 1878 and 1893 respectively. In neither country were they convertible into gold for internal purposes, though they were as good as gold for it. For international purposes, however, both these countries used gold, though it was also legal to use only silver.

SUMMARY

1. The period from 1893-98 was a period of transition. The Coinage Act of 1893 closed the mints to the public for free coinage

of both gold and silver, though left them open to the Government for this very purpose on its own behalf. The notifications issued in this connectio authorised the Government to receive gold coins and bullion in exchange for rupees and in discharge of sums due by the people to it at 7·53344 grains per rupee and issue notes in exchange for them at this very rate. The inherent ot this legislation were inconvertibility of rupee coins, absence of an obligation upon the Government to pay gold in exchange for rupees and ignoring the rupee melting point.

2. The rate of exchange continued to fall from 1893 to 95 due to certain causes but thereafter it rose slowly but steadily.

3. The Gold Note Act of 1898 authorised the issue of notes in Indi against gold received by the Secretary of State for India in in London though in the first instance on temporarily.

4. The Fowler Commission was appointed in 1898 to establish a satisfactory system of currency in India and secure as far as practicable a stable exchange between India and the United Kingdom. They recommended a gold standard with gold currency for circulation for this country and advanted convincing reasons for it. Their other recommendations were (1) giving a legal tender characteristic to British sovereigns, and opening the Indian mints to their free coinage, (2) allowing the Government to give rupees in exchange for gold but forbidding it to coin them for some time more. (3) establishment of a special gold reserve out of future profit of coinage, (4) allowing the Government to discharge its obligatios in India in gold instead of rupees if convenient, (5) making availability of gold obligatory upon it for export if exchange showed a tendency to fall below the specie point, (6) fixing the value of rupee at 1s. 4d. and (g) keeping it unlimited legal tender inspite of its being a token coin.

TEST QUESTIONS

1. What important changes were brought about by the Indian Coinage Act of 1893 and notifications issued in that connection ? Give in brief the inherent defects of this legislation.

2. Why did the rate of exchange did not rise immediately as a result of the passing of the Indian Coinage Act of 1893 and issuing of the notifications in that connenction ? Discuss the reasons advanced by you.

3. Give in brief the arguments advanced by the Fowler Commission in support of a gold standard with gold currency in active circulation for this country.

4. Summarise the recommendations of the Fowler Committee. How far do you think it meant the establishment of a gold standard with sold currency ?

CHAPTER V

GOLD EXCHANGE STANDARD

The Fowler Commission had set before the Indian authorities the object of an effective establishment of gold standard. The Government of India decided to take action on its recommendations. *The Indian Act No. XXII of 1899 was passed.* It made *sovereign and half-sovereign legal tender* throughout India at Rs. 15 : £ (1s. 4d. : Re). *Active steps were taken to open a mint for the coinage of gold in India.* An active effort was also made to induce the people *to use gold coins* as a medium of exchange ; and Currency Offices, Post Offices, and other Government institutions were instructed to pay these to the public. But this proved unsuccessful. A large number of gold coins returned to Government Treasuries. In many places sovereigns went to a discount of 4 as. But there was a demand for rupees, and *the Government contrary to the recommendations of the Fowler Commission, was compelled to resume their coinage* early in 1900. The profits on it were, however, credited to a *separate gold reserve* which finally came to be known as a gold standard reserve[1]. After 1900. *the experiment of putting gold coins into circulation was not repeated.*

1. Divergence made from Fowler's scheme

Subsequent events are such as show that there was a great divergence made from Fowler's scheme.

(1) It has already been pointed out that the Government, contrary to the recommendations of the Fowler Commission, was compelled *to resume coinage of rupees* early in 1900.

1 The designation of the reserve was changed from Gold Reserve to Gold Standard Reserve in 1906 when it was decided to hold a part in rupees ; but this change of title did not make the position clearer as acknowledged by Keynes *vide* Indian Currency and Finance.

There were certain reasons for this. In the first place, there was a general monetary stringency. We know that rupees had not been coined since 1893. On the other hand, production and trade had in general increased. Secondly, there were consequences of the Gold Note Act of 1898. Paper Currency was being issued under this Act against gold deposited in London. This additional issue had the result of adding to the drain on rupee reserves of the Government of India. Notes were then convertible in rupee coins. Thirdly, gold coins which were issued to make good the shortage of rupees, returned to the Treasuries. Fourthly and finally, famine conditions which prevailed about this time necessitated small payments, and these could only be made in silver coins, not in gold.

(2) Because of the return of gold coins at this time to the Treasuries, it was concluded by the Government that *the people did not want gold coins.* The conclusion was wrong because both the time and manner of putting gold coins into circulation were ill-chosen. Famine conditions were prevailing then. Besides, the method of forcing gold coins simultaneously from several sides on the people was not good ; it rather created suspicion in their minds.

(3) A gold mint could not be instituted without the sanction of the Royal Mint, if it was to coin British sovereigns and half-sovereigns. And we know that the Fowler Commission had made only these and no other gold coins legal tender. Hence, the sanction of the Royal Mint was necessary. But far from giving the sanction, the British Treasury objected to the establishment of a gold mint in India on various grounds. It did not think that sufficient gold would be available in this country to enable the mint to continue for a long time. Nor did it think that it would be advisable to let the Indian Treasury bear its cost. Besides, it questioned the very necessity of a gold mint for India. The failure of the Government to introduce sovereigns, as already pointed out, helped it a good deal in its arguments against an active circulation of gold currency in this country. As a result *the idea of a gold mint had to be dropped in 1902* after the completion of the steps taken in this connection.

(4) The gold standard reserve had been created according to the recommendations of the Fowler Commission, but its *form, location and use were changed.*

First of all, the Secretary of State decided that the profits on coinage be sent to London for investment in sterling securities. He argued that since London was the place in which the reserve would be needed on the occasions of emergency against which it was created, it would be the best place for keeping it. Accordingly, for the first few years from 1901 onwards, the profits on the coinage of rupees were sent to London for investment. Gold in paper currency reserve was taken out for this purpose in exchange for newly coined rupees. The interest earned on securities was also credited to the gold standard reserve. It may be pointed out that according to the recommendations of the Fowler Commission, the whole of it was required to be kept in gold, and in India.

Secondly, in 1906 some difficulty was felt in the conversion of notes out of the paper currency reserve, as a portion of it had been transferred to London in the previous year on the plea that it could be used there, as and when required, in purchasing silver, thus saving three or four weeks' delay in shipping them from India at the moment when actually required. This necessitated the formation of a special reserve in rupee coins, besides the paper currency reserve. Hence, two branches of the gold standard reserve came to be formed, (1) in the form of rupees in India, and (2) in the form of sterling securities in London. But both these forms were contrary to the one recommended by the Fowler Commission.

Thirdly, the whole of the profits on coinage did not continue to be credited to the gold standard reserve. In June, 1907, a Committee, known as the Mackay Committee, appointed by the Secretary of State to consider the question of Indian Railway Finance, recommended the transference of a sum of £1 million out of the profits of coinage in that year to the provision of adding rolling stock and other improvements for Indian railways. The Secretary of State went much beyond it. He decided that in future one-half of any profits on the coinage of rupees should be used for capital expenditure on railway until the gold standard reserve reached £20 million. From this, it appears as if all the profits on silver coinage were to be diverted from the reserve after its reaching this figure. In actual practice, £1,123,000 had been so transferred before the crisis of 1907-08 occurred which made him change his decision.

Fourthly and finally, the use of gold standard reserve was changed. We know that from 1901 onwards, profits on coinage were sent to London for investment on the plea that the reserve would be needed on the occasions of emergency against which it was created in that place. In 1907-08 this emergency arose. India's balance of trade turned unfavourable and there came up a demand for gold for exports. According to the recommendations of the Fowler Commission the Government should have met this. But there was no gold in the gold standard reserve in India. First of all, it was given out of the paper currency reserve with some limitations. Then, it was decided on the 4th March, 1908, to make weekly sales in India of a certain maximum quantity of sterling bills on London at the fixed rate of 1s. 3$\frac{29}{32}$d. and on the 26th March, 1908, they were first sold. During the interval, the Secretary of State took steps to realise some of the securities held in the gold standard reserve in order to have cash to meet the bills sold in India. These bills continued to be sold in this country till the 11th September, 1908, on which date the exchange strengthened. In all £8,058,000 were withdrawn during this period out of the gold standard reserve to meet these bills. Besides, it has already been said previously that a branch of the gold standard reserve was held in India from 1906 onward in rupees for conversion of notes.

(5) The Fowler Commission thought that gold would continue to flow into India. *But this was not allowed to be so.* We already know that the Secretary of State sold council bills to obtain funds to meet home charges. After the passing of the Gold Note Act of 1898, he sold these also to obtain funds to purchase silver for coinage of rupees required to enable the Government to convert paper currency into them. It

has already been said that this Act was, at first, meant to be in force for only six months but later on extended for two years. In 1899, it was made permanent. In 1904, the Secretary of State notified his willingness to give rupees for sterling without limit (i.e., over and above his requirements) at the price of 1s. 4⅛d., which was the normal gold export point from London to India. Sometimes, he increased the sales of the bills by selling them below the gold export point as well. The net result of all this was what is obvious. In normal times, one of the methods of paying for India's favourable balance of trade was by the remittance of gold bullion and sovereigns to India. But the action of the Secretary of State as given above resulted in its prevention. Whatever gold was imported into India during this period was imported as merchandise and not in payment for her exports.

It may be concluded that while the Fowler Commission recommended the establishment of a gold standard with active gold in circulation for this country, *Government of India built up a system of currency which was quite different from it and had nothing in any legislative enactment as its basis.* It grew of itself from executive practice and depended on the executive will. We shall look to it presently.

2. Evolution of gold exchange standard in India

The system of currency built up by the Government of India in all these years was the same as proposed by A. M. Lindsay and placed before the Fowler Commission but rejected by it. He had always maintained that "they must adopt my scheme despite themselves" and he was right. Gold exchange standard as it was called, as has already been observed, was first adopted by Holland in 1877 and then by Russia and Austria-Hungary in 1892. But it was first adopted in a complete form in India, as pointed out by J. M. Keynes in his book entitled Indian Currency and Finance, page 33.

We know that *the Secretary of State sold Council Bills,* and when he began to sell these without limit at the price of 1s. 4⅛d. which was the normal gold export point as well or less, the exchange rate could not rise above it. Importers of

Indian goods had the other alternative of paying for them, *i.e.*, by sending gold bullion or coins into this country. Those were accepted here at 1s. 4d. per rupee, and the cost of sending them though always varied was never more than $\frac{1}{8}$d. Hence, it was always preferable to them to purchase council bills if they were available at a rate of 1s. 4$\frac{1}{8}$d. or less. Nor could the market rate of exchange under the circumstances rise above this rate. Hence, the Secretary of State prevented the rate of exchange from rising above this point by offering to sell council bills without any limit at this rate.

The usual procedure for selling these bills was that they were offered in London for tender at the Bank of England every Wednesday morning, the Secretary of State for India in Council (or, for short, the India Council, whence the name Council Bills) having previously announced the amount for which tenders were invited. There was a reserve price which was not published below which he did not sell. Tenders disclosed the amount tendered for and the number of pence per rupee which was offered. The total amount was then allotted to the highest bidders, the allotment at the minimum rate accepted being proportionate to the amount applied for at that rate.

It should be added that cash was required to be paid for bills in London as soon as they were allotted. But on account of the time taken by the mail, they could not be changed into rupees at Calcutta for about a fortnight. Interest for this period was, therefore, lost and it was worth paying extra to obtain telegraphic transfers by means of which rupees could be obtained at Calcutta immediately. The Secretary of State, therefore, was usually willing to sell telegraphic transfers at a rate $\frac{1}{32}$d. per rupee higher than the rate for bills.

The sale of council bills was one facet of the gold exchange standard system, and it continued so long as India had a favourable balance of trade. But in 1907-8, the balance of trade of the country turned unfavourable. There arose a demand for gold for export purposes. According to the recommendations of the Fowler Commission, the Government of India should have met this. But there was no gold in the gold standard reserve in India. First of all, it was given out of the paper currency reserve with some limitations. Then, it was decided on the 4th March, 1908, to make weekly sales in India of a certain maximum quantity of sterling bills on London at the fixed rate of 1s. $3\frac{29}{32}$d, and on the 26th March, 1908, they were first sold. *These bills were known as Reserve Councils. and they completed the other side of the picture of gold exchange standard.* So long as they were available at 1s. $3\frac{29}{32}$d. the rate of exchange could not fall below it as nobody would have liked to have less than this amount for a rupee from anywhere else when this was available from the Government. On this particular occasion, the Government though sold these every week till the 11th September, 1908, on which date, these change strengthened, it sold only a certain maximum quantity. What was necessary was a sale without any limit. Later on, and specially when the rate of exchange showed a tendency to fall just after the out-break of the war, it sold these without any limit.

3. Mechanism of gold exchange standard in this country

The mechanism of gold exchange standard in this country consisted of (1) the council bills and reserve councils, (2) the gold standard and paper currency reserves and cash balances of the Government of India and the Secretary of State for India.

The Council bills were paid in India out of the rupee reserve held partly in the paper currency reserve, partly in the gold standard reserve and partly out of the cash balances of the Government of India. Reverse councils were, on the other hand, paid in London out of the sterling reserves held partly in the paper currency reserve, partly in the gold standard reserve and partly in the London cash balances.

4. The period from 1909-13

From 1909 to 1913 India enjoyed a period of exceptional prosperity, and during this period, demand for remittances from London to India was so strong as not only to call for the re-issue of the large stocks of rupees accumulated during the crisis of 1907-8, and thus incidentally *to restore the gold standard reserve in London to its former amount,* but also to necessitate coinage of fresh rupees, the profit on which went to increase the Reserve far beyond the maximum point reached before 1907-8.

Next, during the period under review *a lengthy correspondence* passed between Government of India and the Secretary of State on the subject of active circulation of gold currency in this country, and of the form, location, and use of and the limit to the gold standard reserve.

The Government of India proposed as follows :—

(1) In its despatch of April 1, 1909, the Government of India pressed for *a larger gold standard reserve* to meet greater emergencies than that of 1907-8. It considered that the minimum amount in the gold standard reserve should be £25 million, apart from the gold in the paper currency reserve and its Treasuries, and therefore, desired that the decision of July 1907 to use a part of the profits on rupee coinage for capital expenditure be held in abeyance until that amount was secured.

(2) It also proposed that a substantial portion of the gold standard reserve should be kept *in a liquid form,* instead of being invested in securities, because during a crisis, the latter could not be readily realised or realised without considerable loss. In this connection, the loss on realisation of securities during the crisis of 1907-8 was pointed out.

(3) It held that it could face another exchange crisis with far greater equanimity, could it be assured of both an active circulation of sovereigns in the country and of a strong reserve in its currency chest. In its despatch of September 30, 1909, it pointed out that though gold was still far from having obtained that popularity which interests of exchange render desirable, *there were indications of a greatly extended use of sovereigns in commercial transactions.*

(4) In its despactch of May 16, 1912, it also asked the *sanction for the coinage of sovereigns* at the Bombay mint.

From 1903 to 1910 little was heard of any proposal for an active encouragement of the circulation of gold. But the intention of having a gold currency had not been altogether given up. In the Budget debate of 1910, Sir James Meston, the then Financial Secretary to the Government of India said, we have reached a gold exchange standard. The next and final step is a true gold currency. In March 1911, Sir Guy Flatwood Wilson, Finance Member to the Government of India in reply to Sir Vithaldas Thackersey who suggested the introduction and minting of a new 10 rupee gold coin said that much has happened since 1902 which justifies the re-opening of the question.

But the Secretary of State was not in favour of an active circulation of gold in India. He championed gold exchange standard. *The reply of the Secretary of State to the above proposals is very interesting.*

(1) As regards the amount of gold to be kept in the gold standard reserve, *the Secretary of States agreed* after a great pursuation that £25 million should be the standard before the profits on coinage could be diverted.

(2) As regrds the maintenance of a considerable portion of the gold standard reserve in a liquid form, *he, however, did not agree.* In its stead, he decided to let out £1 million in short loans or to put into bank deposits. Of the balance, he agreed to hold a considerable portion in high class securities with a near date of redemption, and the remainder in Consuls or other approved stocks.

(3) As regards the maintenance of exchange rate, he held that this did not require an active circulation of sovereigns or gold to be kept in currency chests. He decided that *the proper place for the location of gold* in the Paper Currency Reserve was London, as it could be made available to defray home charges in case the sale of Council bills was rendered impossible on any occasion. Besides, it could be used to strengthen the rate of exchange by being made available to pay up the reverse Councils sold by the Government of India during an emergency.

(4) On an objection of the British Treasury to sanction the coinage of sovereigns at the Bombay mint, and a request of the Government of India, thererefore to grant permission for the coinage of a new 10 rupee gold coin in its despatch of October 18, 1912, the Secretary of State acceded to it. But *the minting was postponed* until the decision on it was given by the Chamberlain Commission which had by then been appointed.

5. The Chamberlain Commission (1913).

This Commission was appointed under the Chairmanship of Mr. Joseph Austin Chamberlain in 1913 to enquire into the methods of maintaining exchange and the location and use of the reserves and balances and to report whether the existing practice was conducive to the interests of India. Obviously enough, it was *precluded from recommending a system other than the one existing*, and in fact supported it.

The Commission said that the belief of the Committee of 1898 was that a gold currency in active circulation is an essential condition of the maintenance of gold standard in India, but the history of the last 15 years shows that *gold standard has been firmly secured without this condition.* It added that the people of India *neither desire nor need* any considerable amount of gold for circulation as currency, and the currency more generally suitable for the needs of India consists of rupees and notes. Under the circumstances, it was natural it concluded that a gold mint was neither required nor considered necessary for India. But it added if Indian sentiment genuinely demanded it and the Government of India was prepared to incur the expense, there was no objection to it provided that the coin minted was sovereign or half-sovereign. The other recommendations of the commission were in connection with the gold standard and paper currency reserves.

Arguments advanced in favour of a gold exchange standard. (1) To a great extent the system evolved by the Government of India is the *result of a series of experiments*, and hence it can not but be the most suitable for the country.

(2) The establishment of the exchange value of the rupee on a stable basis has been and is of the first importance to India, and as *this has been achieved* under the system evolved by the Government of India, it cannot but be extremely sound.

(3) The system evolved has *close affinities with other currency systems* in some of the great European and Asiatic countries, *e. g.*, Holland, Russia, Austria-Hungary and Japan. In these countries, as in India, gold actually in circulation is of secondary importance, and the internal medium of exchange, whether it be a silver coin or a paper note, depends for its value in exchange not on its own intrinsic worth, but on the maintenance in reserve of gold or resources readily convertible into gold, and in the case of Russia and Japan, at any rate, large portions of gold resources are held not at home but in London, Paris and other monetary centres, just as India's gold standard reserve is held in London.

(4) It is desirable *to educate the people in the use of more economical forms of currency than gold.*

Sir James Begbie, a member of the Commission, did not support this standard.

Arguments advanced against gold in circulation. (1) Most people believed that gold circulation was calculated in the long run to strengthen exchange. But the Majority of the Commission *did not agree with this view.* It said that there was, first of all, a belief that if gold were to be used in India to the same extent as say, in the United Kingdom or Germany, the exchange problem would be largely simplified. But this was erroneous. The stability of exchange depended in those countries in fact on the central reserves of the banks of these countries with their influence on other banks and the money market. If, however, the people thought that gold in circulation should be used to a very great extent as for example in Egypt, it would necessitate the reduction of note-issue to a comparatively insignificant position, and withdrawal from circulation, at large expense, of a considerable part of rupees. This would surely result in the performance of gold of the function of strengthening exchange successfully. Instead of a wholesale introduction of gold, there was also a possibility of its gradual introduction. But gold must, under the circumstances, continue to occupy for many years to come a subsidiary position in the currency, and exchange would not benefit materially thereby. Finally, there was the question of the source from which gold was to come, and if it was to take the place of rupees, profit on coinage would be stopped and the very source of the gold standard reserve would be chocked up ; and if it was to take the place of notes, there would be depletion of the paper currency reserve which serves as a substantial aid to the gold standard reserve.

(2) *Gold is a far more formidable rival to note-issue* than to rupees, and to habituate a people to the use of sovereigns is almost certain in the long run to militate against the use of notes which is not a desirable goal. Notes constitute a more desirable form of currency than gold coins.

(3) Many people believed that gold currency was a necessary step towards what may be regarded as the ideal currency, *viz.*, paper backed by gold in reserve. The Majority *did not subscribe to this need.*

(4) It was argued by some that the Indian system was artificial and hence bad. But the Majority *did not subscribe to this view as well.*

(5) The Majority also regarded *gold in circulation as wasteful*, because of the wasteful habit of hoarding prevailing in India. It held that this habit was sanctioned by the experience of centuries in India and by religious and racial laws and customs.

(6) The Majority also concluded that India *neither demanded nor required gold coins for currency*. This statement was quite wrong in view of the experiences of the past several years.

Sir James Begbie argued differently in respect of all these points.

Summary of the recommendations of the Camberlain Commission.

(1) The gold exchange standard is suited to India.

(2) The gold standard reserve be strengthened.

(3) No limit be placed to the amount of the gold standard reserve. All profits on coinage be credited exclusively to it.

(4) A much larger portion of the gold standard reserve be held in actual gold. It should be raised, as opportunity offers, to £15 million, and thereafter one-half must be held in gold.

(5) The rupee branch be abolished, rupees being handed over to the paper currency reserve in exchange for gold.

(6) The proper place for the location of the gold standard reserve is London.

(7) The Government of India should 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 (in case of a fall in exchange).

(8) The paper currency system of India be made more elastic. The fiduciary portion of note issue be increased at once from Rs. 14 crores to Rs. 20 crores, and thereafter fixed at a maximum of the amount of notes held by the Government in the Reserve Treasuries plus $\frac{1}{3}$rd of the net circulation.

(9) 500 rupee notes be universalised and greater facilities given for the encashment of paper currency.

(10) Temporary advances be made out of the fiduciary portion of the paper currency reserve to the Presidency Banks on prescribed terms to relieve seasonal stringency.

(11) It would not be to India's advantage to encourage increased use of gold and gold currency is not necessary for India.

(12) A gold mint is not necessary for India. But if Indian sentiment genuinely demands it, and the Government is prepared to incur the expenses, a mint may be opened for the coinage of British sovereigns and half-sovereigns. If however,

this is not done, the notification of the Government's readiness to receive refined gold in exchange for rupees or notes at the Bombay mint be renewed. [The notification of 1893 had been withdrawn in 1906).

(13) The Secretary of State should continue to sell Council bills if he can,[2] so long as there is a demand for them but at rates never below par.

6. Break-down of gold exchange standard in India

Before the recommendations of the Chamberlain Commission could be given effect to, the Great War came on, and the Indian currency system was once again left to the will of the executive.

Amongst other effects of the war, the first was *the weakening of exchange.* It was met by the proved expendient of offering reverse Councils on London. Between 6th August, 1914 and 28th January, 1915, they were sold to the extent of £8,707,000. In February, 1915, demand for Council bills revived. There arose a slight weakness again in 1915-16 and between November 1918 and April 1919. But this was tide over on these two occasions as well by resorting to the sale of reserve Councils.

There arose at the end of 1916 acute complications in the sphere of Indian currency and finance, and these resulted finally in *the break down of gold exchange standard* which had received the praise and approval of the Chamberlain Commission. We know that there was one defect in the fixation of the value of rupee at 1s. 4d., *viz.*, that the rupee melting point had not been considered. When the price of silver rose to more than 43d. per ounce, it could not be possible to continue selling bills at 1s. 4d. for which one rupee had to be paid by the Government of India and which cost more than 1s. 4d. We shall discuss it in a greater detail in the next chapter.

2They were to be sold so long as there was a need for transference of public funds from India to England, whether in the gold standard reserve or paper currency reserve or government balances and they could be paid in India.

SUMMARY

1. As a result of the recommendations of the Fowler Commission Indian Act No. XXII of 1899 was passed making sovereigns and half-sovereigns legal tender in India. Steps were also taken to open a mint for the coinage of gold in this country and to use gold coins as a medium of exchange But soon a divergence was made from the Fowler's Scheme. *First of all*, coinage of rupees had to be resumed in 1900. *Next*, on the return of gold coins from circulation because of the peculiar conditions then existing in the country, it was concluded that the people did not want gold coins and the experiment of putting them in circulation again was not repeated after 1900. *Thirdly*, the idea of a gold mint had to be dropped in 1902. *Fourthly*, the form, location and use of the gold reserve which was established in pursuance of the recommendations of this Commission were changed. *Fifthly*, quite contrary to the wishes of the Commission gold was not allowed to flow into India by issuing Council bills in London to an unlimited extent.

2. Gold exchange standard though not adopted first in this country was adopted in its complete form here. The Secretary of State prevented rate of exchange from rising above 1s. $4\frac{1}{8}$d. by issuing Council bills to an unlimited extent at this rate and the Government of India prevented it from falling below 1s. $3\frac{29}{32}$d. by issuing reverse councils. The Council bills were paid in India out of the rupee reserves held partly in the paper currency reserve, partly in the gold standard reserve and partly out of the cash balances of the Government of India. Reverse conncils were, on the other had, paid in London out of the sterling balances held in two reserves and cash balances with the Secretary of State.

3. The Mechanism of gold exchange standard consisted of the council bills and reverse councils and the two reserves and cash balances.

4. During the period from 1909 to 13, first of all, gold standard reserve went on rising, Next, a lengthy correspondence passed between the Secretary of State for India and the Government of India regarding the future of Indian currency.

5. As a result of above correspondence Chamberlain Commission was appointed in 1913 to enquire into the methods of maintaining exchange and the location and use of the reserves and balances and to report whether the existing practice was conductive to the interests of the country. This in its turn, gave an unequivocal support to gold exchange standard, singing songs of its praises and denouncing gold currency standard. Its other recommendations were regarding the actual working of the system and popularising and management of note currency.

6. But before the recommendations of the Chamberlain Commission could be given effect to, the war of 1914-18 broke out. Amongst other things, the first was the weakening of the exchange rate. But this was maintained by the device of issuing reverse councils. At the end of 1916, arose acute complications in the sphere of Indian Currency and finance which resulted in the break-down of gold exchange standard.

TEST QUESTIONS

1. What important deviations were made by the Government of India from the recommendations of the Fowler Commission after the year 1900 ? Give a brief discussion of these.

2. When and why did India adopt gold exchange standard ? Name the authority responsible for its maintenance indicating the methods adopted by such authority for this purpose.

3. Why and how was gold exchange standard established in India ? (Delhi).

4. What part did gold play in Indian Currency system before the war of 1914-18 ?

5. What arguments were advanced by the Chamberlain Commission in support of a gold exchange standard and against gold in actual circulation ?

6. What were the findings of the Chamberlain Commission ? Mention in brief their various recommendations.

CHAPTER VI

THE PERIOD 1914-19 (WAR AND ITS EFFECTS)

The history of Indian currency during the war may well be divided into two parts :—

Period I. The first period ends with the completion of the year 1916. During this period there was *general dislocation of trade and business* as a result of the first shock of the war, with its attendant effects.

Period II. The second period begins with 1917 and continues up to 1919. This is the period of *an abnormal rise in the rate of exchange and consequent difficulties.*

1. Period I (dislocation of trade and business)

The outbreak of war caused a panic which led to a dislocation of trade and business of which *the principal symptoms were as follows :—*

(1) Weakening of exchange.

(2) Withdrawal of savings bank deposits, and bank deposits.

(3) A demand for the encashment of notes.

(4) A run on Indian gold stock.

Remedial measures. (1) The remedial measures in connection with the weakening of exchange have already been mentioned (*the offering of the reverse councils*). The Chamberlain Commission had strongly approved of this measure.

(2) Net withdrawals of savings bank deposits in the first two months of the war amounted to Rs. 6 crores, and subsequent withdrawals during the year 1914-15 amounted to

abount Rs. 2 crores. But *continuous payment restored confidence* and in the following years there was a net increase (in 1917-18, however, there was a fall by Rs. 1 lakh). The amounts outstanding at the end of the years 1913-14, 1914-15, 1915-16, 1916-17, 1917-18, 1918-19, and 1919-20 were in lakhs of rupees 2316, 1489, 1532, 1659, 1658, 1882 and 2134 respectively. There was also a run on banks, but this proved of short duration.

(3) Net encashment of notes during the year 1914-15 and specially after the outbreak of the war amounted to Rs. 601 lakhs. But after this, there was *an increase in active circulation*. At the end of the years 1914-15, 1915-16, 1916-17, 1917-18, 1918-19 and 1919-20, it was in lakhs of rupees 4396, 5319, 6708, 8430, 13358 and 15378 respectively.

(4) There arose a keen demand for gold 'in exchange for notes, and the Government derised to meet it to restore confidence. Between the 1st and 4th of August, 1914, it lost about £1,800,000 worth of gold. From 5th August, *the offer to private persons had to be suspended*.

The loss of confidence also gave a set-back to trade and business. But after sometimes this also revived.

2. Period II (abnormal rise in the rate of exchange and consequent difficulties)

The most serious effect of war came to be felt from the end of 1916. During the period following, there was witnessed *a rapid rise in the price of silver*; and it became increasingly difficult to supply it to meet the heavy demand for coinage of rupees in India. This high price of silver together with its dearth made it extremely difficult to maintain the currency system and the exchange rate.

The difficulties arose because of the following reasons. *(1) Favourable balance of trade.* India had usually a favourable balance of trade. But this went on rising during the war years.

Year		Exports £		Imports £		Favourable balance
1914-15	...	121,061,100	...	91,952,600	...	29,108,500
1915-16	...	£131,586,800	...	87,500,200	...	44,026,600
1916-17	..	160,591,200	...	99,748,000	...	60,843,200
1917-18	...	161,700,000	...	100,280,000	...	61,420,000
1918-19	...	169,230,000	...	112,690,000	...	56,540,000

The reasons of the increase in the favourable balance of trade were mainly two. (1) India could not import much from foreign countries, as they were engaged in war and whatever production they had, it was for the immediate need of the battlefield. The slight increase was due to a rise in prices. The quantity fell. (2) Exports from India increased both in bulk and price, as they were in great demand in belligerent countries which required more raw materials and foodstuffs than before, not only for home consumption, but also for carrying on the war.

The large balance of trade indebtedness in India's favour resulted in the strengthening of exchange and heavy demand 'on the Secretary of State for Council bills and on the Government for home currency.

(2) *Exceptional disbursements.* India formed the base of military operations in the Eastern theatres of war, and the Government of India had to pay the soldiers and meet civil expenditure of the occupied territories on behalf of the British Government. Total amount in this connection reached the figure of £240 million. It was, of course, recoverable. But in the meantime, it had to be paid in home currency. In addition, purchases were made in India on behalf of certain Dominions and Colonies.

(3) *Heavy decline in imports of precious metals.* Ordinarily, India imported a huge amount worth of precious metals. But these could not be brought during the war period because of the war-time export restrictions in foreign countries and transportation difficulties.

(4) *Absorption of rupees.* There was a great absorption of rupees because of above reasons. Besides, trade and business were on an increase and this naturally created a demand for currency. The annual average for five years preceding the war, and during the war, of the absorption of rupees, was in lakhs of rupees 878 and 2208 respectively.

(5) *Rise in price of silver.* Besides the rise in India's demand for silver, there was also a rise in its demand from other countries. Most countries used silver in absence of gold. Demand from China also came up. Before 1917, it was a seller, but since that year it became a competitive purchaser. On the other hand, the world production of silver, during this period, decreased heavily due to political disturbances in Mexico which was a principal silver producing country of the world. This resulted in an unprecedented rise in its prices as is evident from the following figures :—

Years.	Prices per standard ounce.
1915	27¼d.
1916 (April)	35⅛d.
1917 (August)	43d.
1917 (September)	55d.
1919 (May)	58d.
1919 (December)	78d.

The rise after the war *i.e.*, during the year 1919 was due to *the fall of the sterling dollar exchange rate.* The price of silver is determined by U. S. A. as that of gold, and hence a fall in the value of sterling in terms of dollars meant a fall in its value in terms of silver as well, which was the same as a rise in the prices of silver. During the latter years of war, sterling remained pegged with dollar, but just after, it, the arrangement was cancelled.

Demand for rupees could not be met due to an abnormal rise in the prices of silver. Besides, *it became profitable for Indians to melt rupees* when the price of silver went above 43d. per ounce or Re. 1 per tola. Finally, *the Secretary of State for India could not continue selling bills at*

1s. 4⅛d, for the obvious reason that while he received only this much for a rupee, the Government of India had to give in home currency silver worth more than this amount.

Steps taken by the Secretary of State and the Government of India. (1) *Control of exchange.* The Secretary of State had to put a limit to the sale of Council bills in London on India, or else the convertibility of notes which were issued in India would have been endangered. This resulted in a divergence between the market rate of exchange and the bills were sold. Next, the bills were sold only to the importers of materials necessary for the prosecution of war.

(2) *Raising the rate of exchange.* When the price of silver rose above 43d. per ounce, it was not possible to sell Council bills at 1s. 4⅛d. and make payment in rupee coins which cost more than this sum. As notes were convertible into rupees, payment could not be made in notes as well. There was always a need for the maintenance of a sufficient amount of rupees for their encashment. Hence, the rate of exchange at which Council bills were sold was raised with a rise in the prices of silver.

Date of change		Minimum rate for immediate T. Ts.
3rd January, 1917	...	1s. 4¼d.
28th August, 1917	...	1s. 5d.
12th April, 1918	...	1s. 6d.
13th May, 1919	...	1s. 8d.
12th August, 1919	...	1s. 10d.
18th September, 1919	...	2s. 0d.
22nd November, 1919	...	2s. 2d.
12th December, 1919	...	2s. 4d.

It may be pointed out that there was a marked rise in the rate of exchange in the year 1919. This was due to the fact that the prices of silver also rose during this year because of the cancellation of the agreement by which sterling dollar exchange rate had been pegged during the latter period of the war.

(3) *Purchase of silver.* To meet the demand for rupees, the Secretary of State for India purchased silver for coinage. But the demand was so enormous that the ordinary market could not satisfy it and an approach had to be made to the Government of U. S. A. for a sale of silver. In April, 1918, U. S. A. Government passed the Pittman Act authorising sale of silver from their reserve and the government of India purchased 20 crores of fine ounces. It was the timely arrival of this silver which enabled the Government to avert a serious currency crisis in this country.

(4) *Exclusion of private buyers from the silver market.* With a view to avoid the competition of the Secretary of State with Indian public in purchasing silver in foreign markets, an import of silver into India on private account was prohibited from the 3rd of September, 1917.

(5) *Acquisition and use of gold.* The shortage of silver led the Government to acquire and use gold. An Ordinance, issued on the 29th of June, 1917, required all gold imported into India to be sold to the Government at a price based on the sterling exchange value of the rupee. A branch of the Royal Mint for the establishment of which sanction could not be received on previous occasions was opened in August, 1918. Pending the establishment of the Mint, a gold mohur, *a 15-rupee coin of the same weight and fineness as sovereign was minted.* The branch of the Royal Mint opened and was closed in April, 1919.

(6) *Sale of gold.* We know that the sale of gold was stopped immediately after the outbreak of the war (5th August, 1914). After the armistice, on the removal of war-time restrictions on the export of gold from belligerent countries, the Government of India bought it in London, U. S. A. and Australia, and made it available to the people. The immediate effect of these sales was a fall in the price of English bar gold from Rs. 32-12 per tola on the 15th August, 1919 to Rs. 27 per tola on the 22nd September, 1919.

(7) *Prohibition of the use of silver or gold coins for other than currency purposes.* Silver and gold coins had begun to

fetch a higher value as metal than as coins. Hence, their use for purposes other than currency was declared illegal from June 19, 1917. Besides, their melting and exporting was also declared illegal from 3rd September, 1919.

(8) *Issue of nickel* coins and Rs. $2\frac{1}{2}$ *and Re. 1 notes.* With a view to economise silver, eight-anna, four-anna and two-anna bits were made of nickel instead of silver, and Rs. $2\frac{1}{2}$ and Re. 1 notes were issued to supplement rupee coins.

(9) *Increase of note-issue.* In spite of the run for encashment of notes made from time to time their gross circulation went on increasing. On 31st March, 1914, while it was Rs. 66·12 crores, on 31st March, 1919, it was Rs. 153·46 crores, and on 30th November, 1919, Rs. 179·67 crores.

(10) *Increase in the fiduciary issue.* On the commencement of the war the fiduciary issue amounted to Rs. 14 crores. But by the end of the year 1919, it had reached the stupendous figure of Rs. 120 crores. Restrictions were imposed on their encashment as well, and the result was a small discount or butta on them in many parts of the country.

(11) *Financial measures.* Other measure taken by the Government, were *to keep down expenditure* as low as possible. *Additional taxation* was levied, and *extensive borrowing* was resorted to from 1917 onward, yielding about Rs. 130 crores. From October 1917, short term Treasury Bills were issued which brought in nearly Rs. 65 crores. During the year 1917-18, *post office cash certificates were also introduced.*

3. Babington Smith Commission

All the difficulties enumerated above, and specially that of securing the convertibility of note-issue led to the appointment of a fresh commission in May, 1919, presided over by Mr. Babington Smith. It was required to examine the effects of war on Indian exchange and currency system and practice and upon the position of Indian note-issue, and to consider whether, in the light of this experience and of possible future variations in the price of silver, modifications of system in practice may be required, and if so, to make recommendations as to such modifications and generally to the policy that should be pursued to meet the requirements of trade, to maintain a satisfactory monetary circulation, and to ensure stable gold exchange standard.

As the terms of reference definitely asked the Commission to make recommendations *to ensure gold exchange standard* after going exhaustively into all the facts of currency and exchange during the war, it made recommendations to ensure gold exchange standard and not any other standard.

Conclusions drawn from war history. The Commission went through the war history very ably, and drew following conclusions :—

(1) The system built up since 1893 worked well, and *was beneficial to India.* It had supplied suitable media for internal circulation, provided means for a settlement of the balance of trade, secured stability between rupee and sterling, and prevented a fall in the value of rupee below 1s. 4d.

(2) *But the system was not a proof against a great rise in the value of silver.* In framing it, this contingency had not been taken into account. Hence, when the unexpected happened, it threw the currency system out of gear.

Stability of exchange is 'desirable. The Commission regarded the stability of exchange desirable because of the following reasons :—

(1) It is *a necessary condition for a free investment of foreign capital* in India, as well as for a protection of capital already in existence, and this was at that time the most required.

(2) It facilitates *free movement of funds* to and from India. This was necessary for assisting commercial finance.

(3) The evils and inconveniences of instability are greater if brought about by administrative acts and not by economic 'causes. The commercial community is pre-

pared to deal with fluctuations of exchange resulting from economic causes, but it cannot deal with them if they are brought about by administrative acts as *they introduce an element of uncertainty* which is beyond reckoning.

(4) A stable exchange gives *the most healthy condition for productian and trade.*

The case for a higher ratio. The Majority preferred a higher ratio for rupees specially because of the following reasons :—

(1) *The price of silver was bound to continue to be high* and if rupee was to be fixed at a higher ratio, it would continue to be a token coin and thus enable the Government to control and regulate the amount of currency in circulation.

(2) The existing rate was high and *its lowering was bound to result in rising prices* and thus cause hardship to the poorer classes.

(3) A high ratio was *advantageous to Indian producers*, as it was expected to keep the cost of materials and machinery down in terms of rupees.

(4) *It was not expected to discourage exports*, as the world shortage of raw materials and food-stuffs was expected to continue and give India a monopoly in its trade.

(5) *Government finances were to gain enormously by a* saving in the remittance of home charges.

Distinction between gold exhange standard and sterling exchange standard. This Commission was the first to draw a distinction between a gold exchange standard and a sterling exchange standard. Sterling had been always considered as a synonym to gold. But during the war, the former had depreciated in terms of the latter, and hence a distinction was necessary. The main argument in favour of a sterling exchange standard was that, as the larger part of the trade of India was with sterling-using countries, rupee-sterling exchange would be advantageous to India. During the year 1918-19, Indian's trade with such countries amounted to 40 per cent for exports and 48 per cent for imports, and with gold-using countries (Japan and America) to 25 per cent for exports and 30 per cent for imports of total exports and imports. The Commission admitted the weight of the argument but held that *a fluctuating exchange would not hamper trade with the United Kingdom and India,* provided trade requirements for remittance were met freely and fully. Next, the Commission thought that ***sterling would soon be restored to gold.***

The arguments in favour of a gold-exchange standard were as follows :—

(1) ***Sterling being a depreciated currency had many inconveniences.*** To link Indian currency to a depreciating currency was to invite all those inconveniences.

(2) It was necessary to maintain the token character of the rupee. If it was to be fixed in terms of sterling, and the latter was to depreciate still further, there was a possibility that this ***token character of the rupee would be jeopardised.***

(3) To avoid the difficulty mentioned in (2) ***it was possible to fix it in terms of sterling at a very high value.*** But the Commission feared that if in the course of the next few years sterling once more became equivalent to gold, ***rupee-sterling exchange might be found to be very high.***

(4) The Commission recommended that ***gold sovereigns be made unlimited legal tender*** along with rupees. Hence, it was essential that the relation of rupee should be fixed with gold.

Hence, the Commission preferred a gold exchange standard. Certain witnesses wanted *to postpone the decision* on the plea that the conditions then existing were abnormal and it was difficult to ascertain how things would take their turn in future. But they were not listened to. The Commission, of course, admitted that the existing circumstances were abnormal ; but as it was anxious to ensure a stable gold exchange standard immediately, it said it could not wait any longer.

Summary of recommendation of the Majority. (1) Rupee be made stable, and automatic working of Indian currency be re-established.

(2) Exchange value of rupee be fixed in terms of gold rather than sterling.

(3) The rate between rupee and gold be fixed at Rs. 10 to a sovereign or rupee one for 11·30016 grains of fine gold or 2*s*. both for foreign exchange and for internal purposes. Sovereigns should continue to be unlimited legal tender, but at the new rate, and a mint be opened at Bombay for their coinage. The recommendation to fix the exchange value of rupee at 2*s*. gold was qualified by the following remark: if contrary to expectation, a great and rapid fall in world prices were to take place and if the costs of production in India fail to adjust themselves with equal rapidity to the lower level of prices, then it might be necessary to consider the problem afresh.

(4) The obligations of the Government to give rupees for sovereigns be withdrawn.

(5) The embargo on the import and export of gold be cancelled.

(6) The prohibition on the import of silver be removed but that on the export of silver be continued. The duty on its imports be also withdrawn.

(7) No limit be fixed to the amount of the gold standard reserve.

(8) The gold standard reserve should contain a considerable proportion of gold.

(9) The balance of the gold standard reserve be kept in securities issued by governments within the British Empire (other than the Government of India) and having a fixed date of maturity of not more than 12 months.

(10) A portion of gold, not exceeding one half, be kept in India.

(11) Though there was no obligation on the Secretary of State to sell council bills, and a settlement of the balance of trade in favour of India could be made by export of gold to India, Council bills be sold so long as possible at rates varying with the cost of shipping gold to India.

(12) The 'Government of India should announce its readiness to sell reverse Councils as soon as the rate of exchange shows a tendency to weaken.

(13) The fiduciary portion of the paper currency reserve be fixed at not more than 60 per cent of the gross circulation.

(14) An emergency currency of Rs. 5 crores be issued to the Presidency Banks on the security of export bills having a maturity not exceeding 90 days.

(15) The permissive maximum of Rs. 120 crores of securities be retained for a limited period.

(16) The holding of the Government of India securities should not exceed Rs. 20 crores.

(17) The balance of the fiduciary portion should consist of securities of other governments within the British Empire redeemable at a fixed date, of which all except Rs. 10 crores worth should be short-dated maturing within one year.

(18) The metallic portion of the paper currency reserve be held in India except for transitory purposes.

Conclusion of the Minority. The Minority consisted of the only Indian member Mr. Dadiba Merwanji Dulal. He concluded as follows :—

(1) The legally established money standard of India was the sovereign with rupees related to each other at 1 : 15. Fowler Commission had recommended this and the Government of India had accepted it. Of course Chamberlain Commission had recommended a gold exchange standard, but this had not even been considered because of the outbreak of war *Gold exchange standard had no validity.* Neither had it been clearly and explicity defined. The authorities used wide discretionary

powers in managing it. The endless issue of token coins, much in excess of what is needed for internal exchange purposes, amount to a form of taxation on the money of the public, Indians are compelled to be fond of precious metals to seek value for their token currency. The standard broke down at a time when India enjoyed a large measure of prosperity.

(2) *There was no need of raising the rate of exchange* on the plea of a rise in prices of silver which could have been prevented by removing the embargo on its exports from India after the signing of the armistice. The prices of silver rose very high only after the ending of the war, He maintained that India could easily have spared silver for exports. This would have been beneficial to her and would have prevented the great rise in prices. The Pittman Act had compelled the Government of U. S. A. to replace all the silver which she had given to other countries, and American production alone was not sufficient for this. Hence, it was expected that a rise in the prices of silver would be continued. Had Indian silver been made available, this would not have been so.

(3) A rise in exchange ratio would cause *set-back to several Indian industries and big losses to Indian exports.* It would also involve enormous loss to India on account of revaluation in terms of rupees of reserves invested in sterling securities and of gold held as part of the metallic reserve against note-issue.

Besides, he took a strong objection to the *interference of the Secretaoy of State for India* on matters of Indian currency and finance. He held that there was no need for the sale of the Council bills at a rate more than 1s. 4⅛d., when the prices of silver had risen. The Secretary of State should have allowed the trade balance to be settled in other ways, e.g., import of gold or sovereign, and this would have resulted in the avoidance of unprofitable coinage of rupees. The one advantage claimed of the circulation of rupee was that it was more economical than gold. But it had ceased to be so, because of a rise in the prices of silver. Hence, *there was no need of its circulation.*

SUMMARY

1. The history of Indian currency during the war of 1914-18 may be divided into two periods. During the first which lasted till 1916, there was a general dislocation of trade and business with its attendant effects. The outbreak of war caused a panic, the principal symptoms of which were (1) weakening of exchange, (2) withdrawal of savings bank and bank deposits, (3) a demand for encashment of notes and (4) a run on Indian gold stock. But soon confidence was restored and the situation improved.

2. The most serious effect of the war came to be felt from the end of 1916, and specially because of a rapid rise in the prices of silver. There was, at that time, a demand for more and more of rupees because of India'a favourable balance of trade, exceptional disbursements of the Government in the country, heavy decline in the imports of precious metals and increase in trade and business. This could not be met because of a rise in the prices of silver brought about by a number of causes. The steps taken in consequence of this were control of exchange raising the rate of exchange, purchase of silver from the Government of U. S. A. exclusion of private buyers from the silver market, acquisition and use of gold, sale of gold after the signing of the armistice, prohibition of the use of gold and silver coins for other than currency purposes, issue of nickel coins and Rs 2½ and Re. 1 notes, increase of note-issue and of the fiduciary issue, keeping down expenditure as low as possible, levying of additional taxes, borrowing and introducing post office cash certificates.

(4) The difficulties mentioned above and specially that of securing the convertibility of note-issue led to the appointment of the Babington Smith Commission. The termsof reference precluded it also to recommend any other standard than the gold exchange standard. Hence, it recommended the same. It went for this purpose, very ably through the war history of Indian currency and pointed out the merits and demerits of the system. According to the Commission, it suffered only from the defect of not being a proof against a great rise in the value of silver and to avoid this and certain other difficulties it recommended ultimately a higher ratio for the rupee, viz., 2s. gold. The Commission also drew distinction, for the first time, between gold exchange standard and stering exchange standard and recommended the fomer. Its other recommendations were in connection with removing the difficulties experienced and restriction imposed during the war period. The Minority consisting of the only Indian member Mr. Dalal differed from the view taken by the Majority. He took a strong objection to the interference of the Secretary of State for India on matters of Indian currency and finance.

TEST QUESTIONS

1. What difficulties were experienced during the first period of the war of 1914.18 and what steps were taken to alleviate them ?

2. Account for the break-down of gold exchange standard during the war of 1914-18 mentioning the causes in detail.

3. What steps were taken by the authorities to meet the situation which had arisen during the latter period of the war of 1914 18 ? Discuss these as elaborately as you can.

4. Trace the causes of the break-down of gold exchange standard in India during the last Great War, and give a brief survey of the measures adopted by the Government to prevent an under-appreciation of exchange.

5. Account for the violent fluctuations in the rupee-sterling exchange during the the 1st Great War.

6. Examine the effects of the rise in the value of silver in 1914-18 on India's trade, industries and the State.

7. Discuss the strong and weak points of gold exchange standard as it prevailed in India before the war of 1914-18 (Punjab-B.A.)

8. Why did the Babington Smith Commission recommend 2s. gold ratio ? Mention in this connection the arguments advanced by them in favour of the stability of exchange, adoption of a higher rate than what prevailed before the war and gold exchange standard as opposed to sterling exchange standard.

9. What were the important recommendations of the Babington Smith Commission ? Mention in this connection the criticism by the Minority.

CHAPTER VII

POST-WAR I DEVELOPMENTS (1920-27)

The Government accepted the recommendations of the Babington Smith Commission, and modified the currency system accordingly embodying them into various notifications.

(1) It was notified that Council bills *and telegraphic transfers would be sold weekly* at competitive prices with a minimum rate varying with the cost in sterling of shipping gold from London to India. Similarly, reverse Councils would be sold in India on London whenever exchange would show a tendency to fall below 2s. gold.

(2) The Government of India had begun selling gold in September, 1919. When the recommendations of the Babington Smith Commission were accepted in 1920, it still commanded a high premium over the price recommended. Hence, the Government announced in February that *during the next six months, it would sell a minimum of 15 million tolas of gold. But this programme was extended by further sales* in August and September. After selling a large quantity at an average rate of Rs. 22 per tola, gold sales were stopped in October, 1920. In the meantime by an Ordinance of 21st June, 1920, *sovereigns and half sovereigns were declared to have ceased to be legal tender*. But as they had been used as currency for long, *a provision was made for their acceptance* by the Government at the ratio of Rs. 15 during a moratorium of 21 days, on the expiry of which the *restrictions on imports of British gold coins were also withdrawn*. Then, in pursuance of the recommendations of the Babington Smith Commission, *sovereigns and half-sovereigns were made unlimited legal tender at Rs. 10 and Rs. 5 respectively*. But market-price remained higher than this, and hence they did not come in circulation. Neither was there any chance for tendering gold for mintage, and hence *the idea of opening a gold mint in Bombay was also dropped.*

(3) In February, 1920, *the prohibition on the import of silver was withdrawn. The import duty of four annas per ounce was also abolished.* Similarly, *the prohibition of the use of gold and silver coins for other than currency purposes was also cancelled.* The price of silver had begun to fall on the very day on which the report of the Babington Smith Commission was tendered, and hence rupees had, since May 1920, begun to come out of hoards. In June, *restrictions on behalf of the Government were accordingly withdrawn.*

1. Breakdown of gold exchange standard (1920)

From the beginning, it was apparent that there was little chance for the maintenance of the new ratio. Mr. D. M. Dalal had been against it. Even the Majority of the Babington Smith Commission, while recommending it, had remarked that *it might be necessary to consider the problem afresh*, if contrary to expectations a great and rapid fall in world prices were to take place and if costs of production in India fail to adjust themselves with equal rapidity to the lower level of prices. *When Government issued the notification regarding the sale of reverse Councils, market price of rupee was higher than 2s. gold. There was thus absolutely no necessity to sell them.* But this was done and it aggravated the situation.

(1) The Government sold reverse Councils. The exporters in India, who had to receive sterling in London also sold their export bills. *There was thus a competition between them and the rate of exchange went up to 2s. 8½d. sterling.* On February 2, sterling fell in terms of dollar and hence gold. This brought the rupee-sterling rate at 2s 10½d. But after this *the tide of the exporters anxious to sell the bills ebbed.* The exporters had sold the bills fearing that *a depreciation of sterling in terms of gold in future would give them less rupees* as they were now linked with gold.

(2) As the rupee-sterling rate rose, *there arose a keen demand for a remittances to London. First of all* there were genuine Indian importers. They sent money in advance, lest it might fetch less of sterling in future. *Next*, foreign businessmen and firms in India found this the most profitable time for remitting their profits to England, *Thirdly*, huge war profits

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had also led to a boom in company promotion, and those wishing to import machines remitted in advance the payment for them. *Finally*, there were speculators who believed that the Government would not be able to maintain a high rate like the 2s. gold rate, and they remitted their money to England in the hope of bringing it back after exchange fell sufficiently, thereby making large profits.

(3) From January to June 1920, *the favourable balance of trade diminished gradually*. Imports increased owing partly to the increased demand for those articles specially piece goods —which had not been imported during the war and whose stock had run low by this time, and partly to the stimulating effect of the rise in exchange on demand. Exports, on the other hand, declined owing to a combination of adverse circumstances. First of all, Japan, an important market for Indian cotton, failed to purchase her usual amount owing to an internal financial crisis. Secondly, Central Europe which used to buy a fairly large amount of Indian goods, stopped purchases for want of purchasing power brought about by political and economic troubles caused by the war. Thirdly, demand for Indian jute, tea and hides fell off partly owing to the accumulation of their large stocks in England and partly to the general uncertainty prevalent at the time in the international market. Finally, the rains of 1920 failed, and food and raw materials could not be continued to be exported.

As a result of the above, *there arose a demand for reverse Councils. The Government provided them at 2s. gold.* At this rate, the price of gold ought to have been Rs. 15-14 per tola. The market price was about Rs. 22-4 per tola. This meant that the *Government undertook to provide gold at a lower rate than available in the market.* Such a great disparity could not obviously be continued. But the *Government persisted.* Babington Smith Commission, as has already been observed, had realised that there was a possibility of the failure to maintain the rate and had provided for its reconsideration. *It was the least pardonable of the errors of the Government* to have ignored this warning.

Various attempts to raise exchange. The Government made serious efforts in various directions to pull up the exchange.

(1) *It sold reverse Council* at rates determined by the fall in the value of sterling in terms of gold less expenses for the shipment of gold during the early months of the year 1920 as follows :—

January	...	...	...	£5,394,000
February	...	...	...	£11,000,000
March	...	...	...	£9,988,000
April	...	...	...	£7,000,000

From the 29th April, the amount of reverse Councils offered weekly was reduced to £1 million and this amount was continued to be offered weekly up to 23rd June.

(2) Finding that the rate could not be maintained at 2s. gold *the Government tried to maintain it at 2s. sterling* on the plea that it would become 2s. gold when sterling would reach the parity. Hence, from 24th September, the rate adopted was 1s. $11\frac{19}{32}$d. But by the end of September, it had become evident that even this rate could not be maintained. Hence, the sale of reverse Councils was altogether stopped.

(3) Beside the sale of reverse Councils, the Government *continued the sale of gold.* In all 53 million ounces were sold, but this had no effect on its premium.

(4) The Government also tried to contract currency with a view to raise the exchange value of rupee. When reverse Councils were sold, currency notes and rupee coins were received in their stead. The currency was thus[1] cancelled. The reverse Councils were paid out of the paper currency reserve, and to the extent the currency notes were cancelled, the paper currency reserve was reduced.

Withdrawal of support (September 1920). At the end of September, 1920, the sale of reverse Councils was stopped

[1] There were two other methods of contraction of currency, *viz.*, (1) selling of the metallic portion of the reserve (the coins were melted and silver sold in the market). and (2) selling of the rupee bills from out of the reserve. They were also resorted to by the Government from time to time.

and the Government regarded the battle to be lost. Left to itself, the exchange adjusted according to the forces of supply and demand, and in December reached 1s. 5d. sterling.

Sacrifices involved in the attempts to raise the exchange rate. The sacrifices involved in the attempts to raise the exchange rate were tremendous. An enormous loss was caused to the Indian Exchequer and industrialists and traders.

(1) In all reverse Councils to the extent of £55,382,000 were sold to maintain the rate of exchange. They were paid in London out of the sterling securities and Treasury bills. These had been acquired at Rs. 15 for a pound, but sold at Rs. 7 to Rs. 10 per pound. *The difference was a heavy loss borne by the Indian exchange.* It amounted to about Rs. 40 crores.

(2) 'The collapse of exchange within 12 months from the level of 2s. 4d. prevailing in April 1920 to below 1s. 3d. was *critical for importers* many of whom had ordered goods when exchange was high without fixing their exchange and who were unable or unwilling to settle at the low rate when the goods arrived. At the close of the year Indian ports remained congested with imported piece-goods, motor cars and other articles of which delivery had not been taken."

(3) *Exporters found themselves loaded with produce* for which there was no foreign demand. Prices went down in the country and they had to suffer.

(4) Besides, *deflation of currency brought the people in difficulty.* In the first place, it made the money market tight and raised the bank rate of interest on loanable money; and in the second place, it tended to lower down the already lowering down prices. Company promoters did not get capital, the already existing concerns did not get market for their produce, and the agriculturists could not realise in many cases even their expenses of production.

2. The Policy of Masterly Inactivity (1921-25)

In 1921, balance of trade was still against India. The rate of exchange which had fallen to 1s. 5d. in December 1920, fell still lower to 1s. 2⅛d (under 1s. gold) in March, 1921. In 1922, the balance of trade began to turn favourable to India, and the rate of exchange reached pre-War level of 1s. 4d. in January, 1923. By October, 1924, it reached 1s. 6d. (about 1s. 4d. gold).

The revival of the export trade was due to good harvests and an improvement in the purchasing capacity of the European countries consequent upon the reconstruction of their currencies.

The rate of exchange strengthened owing partly to the revival of exports and partly to the contraction of currency. Some of the writers say that the Government followed during this period a policy of masterly inactivity but this is not true. As Dr. Jain says, '*the exchange was not, as is sometimes supposed, left to look after itself. But it was managed on expedients different from those adopted before.*' Reverse Councils were not sold, but in their stead currency was contracted. According to an official statement currency was contracted to the extent of Rs. 31,58,00,000 in the year 1920-21 and it continued to be so in the years 1921-22 and 1922-23 by the transfer of sterling securities held in London to the Secretary of State's cash balance and by the discharge of Indian Treasury bills held in the reserve. The net contraction affected during 1921-22 and 1922-23 was 11 1lakhs and 569 lakhs respectively.

A rise in exchange rate above 1s. 6d. sterling was prevented by the Government by introducing the practice of purchasing sterling in India. The purchase of sterling in India has the same effect as the sale of Council bills in London.

Advantages of sterling purchase over sale of Council bills. The advantages claimed for sterling purchase are as follows :—

(1) Initiative in making remittance of sterling to London is transferred to the Government of India to whom it should rightly belong.

(2) Purchases of sterling can be regulated with reference to the conditions of Indian exchange market and heavy fluctuations in exchange rate avoided.

The system of sterling purchase has gradually displaced since 1924 the sale of Council bills. At present, as we shall see later on, this is the main weapon adopted for the prevention of the rate of exchange to rise above the maximum of 1s. 6d.

3. Hilton Young Commission

In April 1925, sterling was restored to gold and U. K. adopted what was known as a gold bullion standard. The rupee-sterling rate which was at that time at 1s. 6d. also became rupee gold rate. In August, 1925, a Commission was appointed under the chairmanship of Mr. Edward Hilton Young to examine and report on Indian exchange and currency system and practice and to consider whether any modifications were desirable in the interests of India and to make recommendations.

The report of the Commission was published in 1926. First of all, it pointed out the defects with which Indian exchange and currency system as prevailing at that time suffered and then it made its own recommendations.

Defects of Indian exchange and currency system as prevelent in 1926. The Commission pointed out the following defects :—

(1) *The system is far from simple*, and the basis of the stability of rupee is not readily intelligible to the uninstructed public. *The currency consists of two tokens*[2] *in circulation, with the unnecessary excrescence of a third full value coin*[3] *which does not circulate at all* One form

2 Rupee coins and notes.

3 Sovereign.

of token currency[4] into which there is an unlimited obligation to convert the other[5] is highly expensive, and is liable to vanish if price of silver rises above a certain level.

(2) There is *a cumbrous duplication of reserves,*[6] with an antiquated, and dangerous division of responsibility for the control of credit and currency policy.

(3) The system *does not not secure automatic expansion and contraction of currency.* Such movements are too wholly dependent on the will of the currency authority.

(4) *The system is inelastic.* The utility of the provision for elasticity made on the recommendation of the Babington Smith Commission is affected by the methods[7] of financing Indian trade.

Recommendations. The Commission made the following recommendations :—

(1) *Gold bullion standard be adopted* as the system of currency. Gold coins should not be introduced into circulation but an obligation should be imposed by law on the currency authority to buy and sell gold in the form of gold bars without limit in exchange for rupees and currency notes. The legal tender characteristic of *sovereigns and half-sovereigns* should be withdrawn. There should be no legal obligation on the Government to give rupees for currency notes.

(2) The control and management of currency should be entrusted to *a central bank* to be established.

(3) *The rate of exchange* should be stabilised at 1s. 6d.

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4 Rupee coins.

5 Notes.

6 Gold standard reserve and paper currency reserve.

7 Indian trade is financed on the basis of cash credits and not on that of discounting bills, and emergency currency can only arise through the latter process.

(4) *One-rupee notes should be re-introduced* as unlimited legal tender. Notes of higher denominations be made convertible into notes of smaller denominations or rupee coins at the option of the currency authority.

(5) The paper currency reserve and the gold standard reserve *should be amalgamated.* The constitution of the combined reserve was laid down.

The minority again consisting of only one Indian member, *viz.*, Sir Purshottamdas Thakurdas differed on most of the points. According to him the change from gold standard to gold exchange standard in the past was in absolute contravention of the currency policy officially adopted in 1899, binding on the Government and the country. He agreed with the recommendation regarding the adoption of gold bullion standard, but wished that there should be *no interference with the free inflow of gold* into India except with due publicity and the concurrence of the Legislature. In his opinion, *demonetisation of sovereigns and half-sovereigns* as recommended by the Majority *was unnecessary.*

He was *in favour of developing Imperial Bank of India into a central bank* as far as possible.

He was against the stabilisation of rupee at 1s. 6d. *He recommended 1s. 4d.*

Alternative standards. The standards alternative to gold bullion standard were (1) sterling exchange standard, (2) gold exchange standard, and (3) gold currency standard. The first two were rejected by the Commission on general grounds. The *objections to gold currency standard* were the following :—

(1) 'A large extra demand for gold from India would cause *increased competition for gold* among the countries of the world and lead to a substantial fall in gold prices and a substantial curtailment of credit.' Credit is based upon gold, and a fall would cause its shortage.

(2) *The actual demand for gold cannot be estimated.* It

is possible that people may begin to prefer gold coins to notes. The fear of a fall in the status of rupee may also cause their conversion into gold coins.

(3) The fall in the demand for silver because of the adoption of a gold currency standard would reduce its price. This would involve *a loss to the Indian Exchequer* on the sale of the surplus silver. It would also *lower down the value of the savings* of the poorer Indian people who invest them in silver ornaments.

(4) The adoption of gold currency standard by India might lead to *demonetisation of silver by China* as well. This would raise the price of gold and thus result in the difficulties mentioned in (1). It would also raise the price of silver and thus raise the difficulties mentioned in (3).

(5) India would not get gold without the co-operation of Great Britain and U. S. A. and *these countries are against the adoption of gold currency standard by India.*

(6) The scheme would prove *costly.* It might mean Rs. 3 crores a year for about 10 years.

Then, there were certain other general objections.

(7) *Gold in circulation is expensive,* while gold in reserve is more useful for bringing about stability in exchange.

(8) Gold currency standard is *a sign of backwardness.* Many countries returning to gold standard after the war did not return to its gold currency form.

(9) The bulk of transactions in India involve *small payments* and hence gold in circulation is not required for them.

Merits of gold currency standard. But India had for long been in favour of gold currency standard. The following were the advantages claimed for it :—

(1) It is an automatic standard.

But it was difficult to say whether it would have been so in India. If the imported gold were hoarded by the people and thus sterilised, prices would have remained the same, and the automatic working of gold currency standard checked.

But this contingency was possible only when the hoarding habit of the people would have persisted even after the introduction of gold currency.

(2) The introduction of gold currency would discourage uneconomic habit of hoarding gold. The assurance that all other forms of currency would be convertible into gold currency would render them as good as gold.

But the Hilton Young Commission thought mere introduction of gold currency would not result in the abandonment of the habit of hoarding.

(3) Gold currency standard would inspire confidence which no other standard can do to the same extent.

(4) India wants gold currency in circulation as is evident from the heavy importation of sovereigns and half-sovereigns during 1900-1914. Besides, the weight of good academic opinion is in favour of gold currency. 'This is pre-eminently a question in which Indian sentiment should prevail'.

(5) Gold currency standard is a stage through which India must pass to attain the ideal, *i.e.*, gold bullion standard.

Gold bullion standard as recommended for India. But gold bullion standard as recommended for India by the Commission was different from that adopted in Great Britain.

(1) While in Great Britain pound sterling retained its pre-war gold parity, *i.e.*, 113'0016 grains gold, rupee in India was recommended to be linked to *a new gold parity, i.e.*, 8'40512 grains gold instead of the pre-War gold parity, *i.e.*, 7'5334 grains gold. Rupee had a statutory gold parity, of 11'30016 grains gold after 1920, but that parity had been inoperative.

(2) Bank of England was under a statutory obligation to buy gold in unlimited quantities at the rate of £ 3.17*s*. 9*d*. per standard ounce (11-12th fine) and to sell gold without

limit, but in quantities of not less than 400 ounce fine at £3.17*s.* 10½*d.* per standard ounce. But in India, the currency authority was to be under obligation *to purchase as well only in quantities not less than 400 ounces*. But in the succeeding Act, this limit of purchase was reduced to a minimum of 40 tolas or 14 ounces of gold. In India the conditions as well which were to govern the sale of gold by the currency authority were to be so farmed as *to free it in normal circumstances from the task of supplying gold for nonmonetary purposes*. In order to achieve this object proposals were made for fixing the selling prices of gold. Finally in the succeeding Act, the option was given to the currency authority to sell gold for delivery at Bombay or sterling in London.

(3) *Sovereigns and half Sovereigns were met demonetised in Great Britain.* But they were so done in India. But with a view to make gold standard visible to the ordinary public, it was proposed to offer 'on tap' savings certificates redeemable in three or five years in legal tender money or gold at the option of the holder. But this was never embodied in a law.

(4) *All silver coins in Great Britain continued to be legal tender up to 40 Shillings only*. In the Indian system rupee coins were to continue to be unlimited legal tender. This was, however, not a defect as pointed out previously. But they were not to be coined until their circulation was reduced to the amount required for small change, the object being to bring them to the same position as silver coins in Great Britain.

(5) In India, *a distinction was proposed to be made between old notes and new notes*. Old notes were to continue to be converted into silver rupees. But new notes were to be convertible only into gold bars. In Great Britain, all notes were convertible into gold bars. In the Act, however, no such distinction was made.

From the above, it is obvious that the Commission did not recommend for India a full-fledged gold bullion standard, and an examination of the law that was subsequently passed, embodying these recommendations, reveals that inasmuch as the currency authority retained and actually exercised the option of selling, in return for internal currency, sterling for delivery in London, the standard adopted in this country was *shilling exchange standard.* But so long as sterling was convertible into gold, it was actually *gold exchange standard* It may be pointed out that both these standards had been discarded by the Commission.

Ratio question. As we know the Commission recommended a 1s. 6d. ratio. The arguments advanced in its favour may briefly be stated as follows :—

(1) At the existing ratio, price in India have attained *a substantial measure of adjustment with world prices* and any change in the rate would mean a difficult period of adjustment, involving widespread disturbances.

(2) *Wages have also adjusted* themselves to the prices at the existing exchange rate of 1s. 6d.

(3) As regards *contracts* least injury will be caused by adhering to 1s. 6d. It is true that land revenue, etc., were settled when the ratio was 1s. 4d, but owing to the rise of prices since then, the incidence has not increased—rather it has become lighter. Contracts settled after 1918 have been settled on the basis of higher rates. They will not at all be affected.

(4) As regards the contention that the then existing depression in jute industry and cotton mill industry could be done away with by adopting a lower ratio the Commission thought that *the depression in question was due to causes which the manipulation of exchange rate could not remedy.*

The arguments against reverting to 1s. 6d. ratio as advanced by the Commission were as follows :—

(1) Though 1s. 6d. rate has been described as the 'natural' rate, it is difficult to understand *in what sense it can be so described.* If Indian exchange were left to itself, there would ensue wide fluctuations in it, and it would be impossible to determine a 'natural' rate.

(2) It was argued that 1s. 6d. rate was approached through *Government manipulation.* The Commission pointed out that the question of the means by which a particular rate has been arrived has no bearing on the extent or violence of the economic disturbances which would result from an alteration in the rate.

(3) It was said that 1s. 6d. ratio would accentuate the fall of prices in India resulting from the fall of world gold prices. But the Majority held that such *a fall in prices was not likely to take place.*

(4) A reversion to 1s. 4d. *would affect the budget very much adversely.* It was estimated that the loss per annum to the Indian Exchequer would be near Rs. 6 crores.

(5) A reversion to 1s. 4d. *would mean a general rise in prices.* This would affect the consumers in general, and will mean an arbitrary reduction of the real wages of labour.

(6) The effect of a reversion to 1s. 4d. would be immediate on foreign trade. *The sudden fall might create a boom which would be followed later by a slump.*

(7) It has been suggested that the stabilisation of rupee at 1s. 4d. will raise the price of gold and check its abnormal import into India for being hoarded. But *import of gold is due to causes which cannot be removed merely by adopting a lower ratio.*

The Minority's arguments against 1s. 6d. were as follows :—

(1) 1s. 4d. ratio was a *de facto* ratio. It had been disturbed during the war, because of abnormal conditions. Even then the Secesetary of State should have ceased selling Council bills when he could not sell them at the legally fixed ratio rather than sell them at higher rates as he did. The Babington Smith Commission deliberately threw it out and fixed an unnatural ratio of 2s. gold which could not be maintained. But when the attempt

to stabilise it at 2s. gold was abandoned, and rupee was allowed to adapt itself to the market conditions, it reached approximately 1s. 4d. gold the *de facto rate* in September, 1924. But it was not stabilised at that. Subsequently, when in April, 1925, pound sterling reached gold parity, the Government fixed it at 1s. 6d. gold. Hence, 1s. 6d. gold rate was achieved in April 1925 and not in September, 1924. In September, 1924, it was 1s. 4d. gold or 1s. 6d. sterling.

(2) From the above, it is obvious that 1s. 6d. gold rate had been in existence only since April 1925. As the discussions were being made in 1926, it was argued that *the new rate had had no time to allow the adjustment of prices, wages, and contracts.* The main argument of the Majority had been that they had adjusted, and a reversion to 1s. 6d. rate would cause a considerable disturbance.

(3) *There was no gain to the Government by the adoption of 1s. 6d. ratio.* No doubt, it meant a saving in the payment of Home charges. But there was bound to be a loss, on the other side, in receipts in connection with customs on exports which were sure to decline. Besides, the adoption of 1s. 4d. rate would have brought about a reduction under bounties to certain industries given on the rise of exchange to 1s. 4d.. Then, there was Income-Tax and Corporation Tax which would have increased as a result of impetus given to industries by the adoption of 1s. 4d.

(4) It would be possible to maintain the currency system of the country with a lesser reserve in gold and sterling if the rate were to be fixed at 1s. 4d. rather than if it were to be fixed at 1s. 6d. The question was whether it was right to fix a ratio that *would require larger resources* to maintain if the fixing of the ratio could be avoided.

(5) A change to 1s. 6d. *would hit the larger bulk of the debtor class* to the benefit of the credit class, and there was no justification to give the latter an unearned increment at the expense of the former.

(6) The Majority had argued that 1s. 6d. rate had no adverse effect on Indian trade with other countries. The Minority replied that *export had not fallen in the meantime only because of good harvests and low holding power of Indian agriculturists, and imports had not gone up only because of the fall in the purchasing power of the masses.*

(7) This raising of rate from 1s. 4d. to 1s. 6d. *would give the foreign exporters a bounty* to the extent of 12½%, and thus be detrimental to the interests of Indian industries.

4. Government Action on the Report

The report was published in 1926. Three bills embodying the recommendations contained therein were introduced in the Indian Legislative Assembly on 25th January, 1927. They were (1) the Currency Bill, (2) the Gold Standard and Reserve Bank of India Bill, and (3) the Imperial Bank of India (Amendment) Bill. Of these only the first was passed into an Act.

The currency Act (1927). (1) The currency notes, the silver rupee, the half silver rupee, all remained legal tender without limit, and open to issue at the will of the Government. *The parity of exchange was fixed at ·847512 grains troy of gold* which was at that time equivalent to 1. 6d. per rupee.

(2) *Gold coins did not remain legal tender,* but could be received at any Government Treasury and Currency Office as bullion at the rate of 8·47512 grains fine gold per rupee.

(3) *The Government was obliged to purchase gold at Rs 21-3-10 per tola* in the form of bars of not less than 40 tolas 15 ounces) of gold at the Bombay Mint.

(4) *The Government was obliged to sell gold for delivery at the Bombay Mint or sterling for delivery in London* in amounts of not less than 1065 tolas (400 ounces) of fine gold or the equivalent amount of sterling) at the

option of the Controller of Currency. Calcutta, or the Deputy Controller of Currency, Bombay at Rs. 21-3-10 per tola of fine gold or as much sterling as was required to purchase one tola of fine gold in London at the rate at which Bank of England was bound by law to give sterling in exchange for gold after deduction therefrom of an amount representing the normal cost per tola of transferring gold bullion in bulk from Bombay to London, including interest on its value during transit. As this was bound to fluctuate, the Governor General had to notify from time to time the rate determined as above in the Gazette of India.

SUMMARY

1. The recommendations of the Babington Smith Commission were accepted by the Government and steps were taken to give effect to them. When Government issued the notifications regarding the sale of reverse Councils, the market price of rupee was higher than 2s. gold. There was thus absolutely no necessity for it to sell them. But the Government did so. The exporters also sold their bills as they were afraid lest a depreciation of sterling in terms of gold in future would give them less rupees, as they were then linked with gold. There was thus a competition between reverse Councils and exchange in the market went up to 2s. 10½d. But soon export bills were exhausted. With a rise in the rupee sterling rate there arose, on the other hand, a keen demand for remittances to London Besides, from January to June 1920, favourable balance of trade diminished and this also aggravated the situation. The Government provided reverse Councils at 2s. gold rate, At this rate, price of gold ought to have been Rs. 15-4-0 per tola. This meant that the Government undertook to provide gold at a lower rate than that available in the market. The Commission had realised that there was a possibility of the failure to maintain the rate and had peovided for its reconsideration. But the Government persisted. It made various attempts to raise the rate, First of all, it continued selling reverse Councils at 2s. gold rate and then at 2s. sterling rate. Next, it continued selling gold. Thirdly, it contracted currency. At the end of September, 1920, however, sale of reverse Councils was stopped. In the attempt to maintain the rate of course, huge sacrifices had to involved. First of all, sterling securities which had been acquired at Rs. 15 per pound had to be sold at Rs. 7 to Rs. 10 per pound. The difference was a heavy loss borne by the Indian Exchequer. Next, the collapse of exchange was critical for importers. Thirdly, exporters could not find market for their exports at such a huge exchange rate. Fourthly and finally, deflation of currency brought the people in difficulty.

2. From September 1920 onward, the rate was left to find its own level. By March, 1921, it reached 1s. 2 7/8d. sterling (under 1s gold). In 1922 the balance of trade, however, turned favourable and the rate reached in January 1923 to 1s. 4d, and in October 1924 to 1s. 6d (about 1s. 4d. gold). This was due to the revival of trade and also contraction of currency. Hence, it is wrong to say that during the period the Government followed a policy of masterly inactivity. Finally the rise in the rate beyond 1s. 6d. was checked by introducing the policy of sterling purchase by the Government which was advantageous to that of selling Council bills by the Secretary of State.

3. In 1925 Hilton Young Commission was appointed. This Commission unlike the two previous Commissions, was free to recommend any standard. The report was published in 1926. It pointed out the defects of exchange standard as prevalent at the time. The recommendations included the establishment of a gold bullion standard and of a central bank to control credit and currency, 1s. 6d. rate of exchange, reintroduction of one rupee notes, and unification of gold standard and paper currency reserves. The minority though welcoming the establishment of gold bullion standard, neither wanted any interference with the free inflow of gold into India, nor demonetisation of gold coins as recommended by the Majority. It also wanted Imperial Bank to be developed as a Central Bank restoration of rupee to 1s. 4d. The Commission examined the alternatives to a gold bullion standard, and rejected gold currency standard. Gold bullion standard as recommended by the Commission differed in certain essentials from that prevailing in England and did not ultimately prove to be different from sterling or gold exchange standard. There was a good deal of difference of opinion between the Majority and Minority regarding the adoption of the exchange rate. In fact, the recommendation of the Majority in this connection provided the main theme of criticism in the following years.

4. The Government in its turn introduced in the Indian Legislature three bills embodying the recommendations of the Majority. But of these only one, *viz.*, the Currency Bill was passed into an Act. This Act fixed the exchange parity at 8·47512 grains of gold coins, and made it obligatory upon the Government to purchase gold at Rs. 21 3-10 per tola in the form of bars of not less than 40 tolas at the Bombay mint and to sell gold for delivery at the same place or sterling for delivery in London in amounts of not less than 1065 tolas of fine gold or sterling of an equal amount at the option of the Controller of Currency at Rs. 21-3-10 per tola of fine gold or as much of sterling as was required to purchase one tola of fine gold in London after deduction therefrom of an amount representing the normal cost per tola of transferring gold from Bombay to London including interest during transit. As this was bound to fluctuate it was notified from time to time in Government Gazette.

TEST QUESTIONS

1. What notifications were issued by the Government of India in consequence of the recommendations of the Babington Smith Commission ? Give detailed explanation of these.

2. What were the effects of the policy of the Government to maintain 2s. gold rate as recommended by the Babington Smith Commission and what steps had to be taken in consequence thereof ? Also please mention in this connection the sacrifices involved.

3. 'The period from 1921 to 25 was a period of masterly inactivity in connection with Indian currency and exchange,' Comment.

4. What were the advantages of the system of sterling purchase over that of the sale of Council bills ?

5. What were the defects of the existing Indian currency system as pointed out by Hilton Young Commission ? Mention also the defects of a gold currency standard as pointed out by them.

6. What were the recommendations of Hilton Young Commission ? Mention in this connection the points of difference between gold bullion standard as recommended by them for India and as prevalent in England ?

7. What were the recommendations of the last Royal Commission on Indian Currency and Finance and how far were they given effect to ?

8. Distinguish between gold exchange standard and gold bullion standard as proposed by Hilton Young Commission. State your views on the latter as a scheme of currency arrangement for the country. (Punjab—B. A.).

9. What were the arguments advanced by the Majority of the Hilton Young Commission in support of 1s. 6d. rate and against 1s. 4d. rate ? Mention in this connection also the arguments advanced by the Minority against 1s. 6d. rate.

10. What were the main clauses of the Indian Currency Act of 1927 ? Give your own opinion on the clause relating to the sale of gold and sterling as contained therein.

CHAPTER VIII

CURRENCY FROM 1927-1939

During the period under review, *agitation centred at first mainly round exchange ratio, and then round exchange ratio and gold exports both.* Besides, there occurred a crisis in 1931, which brought out *the real characteristic of Indian currency.* The standard adopted in 1927 was fairly elastic. It was sterling exchange standard as the Government really exercised its option of giving sterling for delivery in London in exchange for Indian currency. But so long as sterling was in parity with gold, as has already been said, this was gold exchange standard as well. Finally, if Government chose to exercise the other option open to it of offering gold in exchange for rupees, it could be, in point of fact, if, not in law, gold bullion standard. Since the occurrence of the crisis referred to above, it became, however, only sterling exchange standard as we shall see presently.

1. Controversy regarding exchange ratio (April 1927 to September 1931)

From April 1927 to September, 1931, trade conditions in India were favourable, both exports and imports registering a rise. This improvement in trade, it was pointed out by the supporters of 1s. 6d. rate, clearly showed that an adjustment had been brought about and the new rate did not affect business at least adversely. But the fact is that the improvement in question was in a large measure the counterpart of much greater improvement in world trade. The supporters of 1s. 4d. rate held that *a lower ratio would have communicated the improvement to Indian trade in a greater measure.*

Next, during the whole of this period, the Government had to resort to *artificial devices* to strengthen the exchange rate. *First of all,* it raised the rate at which it was prepared to lend emergency currency to Imperial Bank. *Secondly*, the Government sold treasury bills and thus contracted currency. *Thirdly*, it sold sterling bills and met the sales by transfers from gold standard reserve and paper currency reserve.

After September, 1929, India became involved in *world trade depression*. There was a crisis in America from where it blew over to other countries of the world. Prices of commodities and securities collapsed everywhere, and in India also they shared the same common fate. There arose a natural reluctance on the part of the investors under the circumstances to invest money. In India this was accentuated by a strong political agitation that was then going on. The Government also continued resorting to artificial devices referred to previously with a view to strengthen the exchange rate, and the contraction of currency that was brought about as a result of this *made the matter still worse*. Prices fell here in a greater measure than anywhere else and balance of trade declined.

2. Crisis of 1931 (Divorce between sterling and gold and its reactions in India)

Britain had adopted gold standard in 1925 with the same parity as it had before the War, while most of the other countries had done this with a lower parity. The consequent result of this was that the cost and prices in the former country remained higher in terms of gold than in the latter countries. It may be said that all through the period from 1925 to 1931, the British Government had to labour hard. There was, on the one hand, *an unfavourable balance of trade* and on the other, *unemployment and depression in industries*. The task of balancing the budget had been, under the circumstances, made difficult. Over and above this, there had been *the effects of the 1929 crisis also which* accentuated the flight of gold from the country. First of all, attempts were made to meet the situation by raising credits in France and U. S. A. But in the end, there was no way left except that of *the abandonment of gold standard*. This was done on September 21, 1931. The obligation placed on the Bank of England by sub-section (*ii*) of section I of the Gold Standard Act of 1925 to give gold bars in exchange for internal currency at fixed rates was removed, and sterling was allowed to find its equivalent by the forces of supply and demand. From this date, it began to fall, and this went on so long as it was not pegged again to American dollar.

Rupee had been linked to gold by the Currency Act of 1927, but an option had been given to the Government to offer its equivalents in sterling as well. The question arose at this stage, when sterling was divorced from gold, whether the Government should in future offer only gold or sterling. There was no legal equivalent of sterling in terms of gold. Hence, it could offer only one at fixed rates. The Governor-General could not take any decision without consulting the Secretary of State. The Legislature was sitting, but he did not think it proper to refer the matter to it. Hence, an Ordinance had to be promulgated which repealad Section 5 of the Currency Act, 1927 and *relieved the Government of the obligation to sell gold or sterling at fixed rates*. The following three days were also declared as bank holidays to prevent speculative activities in exchange. The Secretary of State on the same day, *i. e.*, on the 21st September, 1931, made a statement before the Federal Structure Sub-Committee of the Indian Round Table Conference informing them that it had been decided to maintain the present standard on sterling basis. On 24th September, 1931, therefore the previous Ordinance was repealed and a new Ordinance, namely, the *Gold and Sterling Sales Regulation Ordinance 1931*, was promulgated. It imposed restrictions on the sales of gold[1] and sterling to genuine trade purposes and resonable personal requirements. The rules made under the Ordinance laid down £25,000 as the maximum amount to be sold to any recognized bank. The object underlying all this was to maintain the sterling value of rupee at 1s. 6d. In its absence, it was feared

[1]It does not mean that it linked rupee with gold. It only allowed the Executive to sell gold or sterling ; and as the Executive sold only sterling, it was sterling exchange standard, and rupee remain divorced from gold.

that rupee would seek conversion into foreign currencies in large quantities causing exchange weakness. In Bombay, in the first ten minutes after business opened and before the market was aware of the issue of the Ordinance, demand for 425,0000 pounds sterling were received. But after some time exchange restrictions did not appear necessary and as a consequence the *second Ordinance was also repealed* on 30th January, 1932. *Since then, the Currency Act of 1927 came into force.* But as the Executive sold only sterling, it is only sterling exchange standard and not gold exchange standard or gold bullion standard. Rupee remained thus divorced since September, 1931, from gold *only because of Executive will.*

The action of the Government in linking rupee with sterling was perhaps the best under the circumstances. But it was subjected to adverse criticism partly because Indian Legislature which was sitting at that time was not consulted in the matter, and partly because the ratio was not revised.

The alternatives to a link with sterling were a link with gold and a free rupee. If rupee had been linked with gold, at 8·47512 grains or 3·53344 grains, it would have become difficult to maintain it. We know that all currencies had to be divorced from gold or linked with it at a much lower figure. In fact, nowhere in the world effective gold standard was maintained. To leave rupee free also would have caused much inconvenience both to the people and Government because of their relations with the world outside India.

Arguments advanced by Government spokesmen against the linking of rupee with gold. The following were arguments advanced by Government spokesmen against the linking of rupee to gold.

(1) If rupee had been linked to gold *strong gold reserves* would have been necessary to maintain the link. The combined gold reserves of both the gold standard and paper currency reserves at that time amounted to £32½ million sterling, according to 8·47512 parity.

(2) To maintain the convertibility of rupee into gold

at a time when there was rush for gold in other countries, *deflation* might have become necessary. This would have worsened the position of Indians.

(3) A fixed ratio in terms of gold would have meant a *fluctuating ratio in terms of sterling* so long as sterling remained fluctuating rather depressing in terms of gold. A fluctuating sterling rate would have reacted adversely on India's trade with Britain and other countries which had their currencies linked to sterling.

(4) If 1s. 6d. sterling rate was regarded as unduly high, 1s. 6d. gold rate or even a lower gold rate would have been still more *objectionable.*

Consequences of stabilisation in terms of sterling. (1) Rupee was tied to *sinking boat of sterling* and thus the fate of India was linked with that of Great Britain.

(2) The depreciation of rupee consequent upon the depreciation of sterling reduced Indian prices in terms of gold, and hence tended to stimulate exports to countries having their currrencies based on gold and to discourage imports from them. In actual practice, *the stimulus to exports was neutralised* by declining world prices and high import duties and other restrictions on imports in them. *In connection with imports as well, it may be said that the effects were neutralised by declining prices.*

(3) This, however, did give *a preference to British exports* in this country over exports from other countries, and specially from those which maintained gold standard. But gradually this was also neutralised, as other countries also gave up gold standard or devalued their currencies.

(4) It enabled the Government and the people to meet their *sterling obligations* without embarrassment or uncertainty.

(5) The most important effect of this action was the *export of gold* from India in huge quantities. This was bound to happen, as sterling and rupee fell in relation to gold which means the same thing as a rise in the prices

of gold. The prices of gold would have, however, not risen, had rupee been kept linked to gold at the old ratio. But then, the position of Indians would have worsened still, and as a result, they would have been compelled to sell gold to make their both ends meet. The Government could have, of course, purchased most of it. But it did not interfere. We shall take up this question in greater detail presently.

3. Gold Exports (1931-1940)

India imported gold and silver on a large scale under Moghul Kings. This was due to the character of her balance of trade.

India's balance of trade was even under British rule in her favour. But there was* a Burden of *Home Charges*—a charge to the revenue of India, a drain of profits from important industrise which were a monopoly of, or controlled by foreign capital, as tea, copper; rubber, petroleum, jute, coal, etc., and invisible imports in the shape of services of foreign shippers, bankers and commission agents, etc. These made her balance of payments turn unfavourable or less favourable than what it would otherwise be. Nevertheless, in normal years, she had even then something to receive. Below is a summary of net receipt of silver and gold by India from 1900-01 to 1939-40.

* Since 1946-47 as well she has been receiving these metals in smaller and larger quantities.

Average for	Receipts of gold		Receipts of silver	
	Quantity in Ounces	Value in rupees	Quantity in Ounces	Value in rupees
1900-01 to 1904-05	9,76,206	6,23,43,774	...	10,11,61,514
1905-06 to 1909-10	18,44,779	11,74,53,065	...	16,14,20,372
1910-11 to 1914-15	41,11,388	25,34,21,717	...	10,61,41,326
1915-16 to 1919-20	21,45,834	13,41,42,776	...	27,96,38,686
1920-21 to 1924-25	45,19,807	28,70,95,282	..	15,72,70,821
Year				
1925-26	61,35,581	34,85,45,799	...	17,12,41,150
1926-27	33,85,529	19.40,05,448	...	19.86,80,335
1927-28	31,81,759	18,10,00,023	...	13,83,68,227
1928-29	37,85,441	21,19,86,978	...	9,77,06,926
1929-30	25,23,562	14,22,08,396	...	8,62,12,198
1930-31	22,42,653	12,75,18,115	...	10,07,93,056
1936-37	...	...	...	13,39,17,471
1937-38	...	...	...	1,50,65,835
1938-39	...	...	...	57,91,606
1939-40	...	...	...	1,48,44,287
Total ...	8,92,44,592	5,47,75,47,829		1,77,02,53,810

From the above, it is obvious that India imported huge quantities of both gold and silver during the first 31 years of this century. In the years 1931-32, there came a change. The net annual exports of both gold and silver for the years 1931-32 and up to 1939-40 are given below :—

Year	Exports of gold		Exports of silver	
	Quantity in Ounces	Value in rupees	Quantity in Ounces	Value in rupees
1631-32	76,29,377	57,97,27,842	...	42,17,088
1932-33	83,53,829	65,52,27,956	...	2,01,30,951
1933-34	66,95,298	57,05,35.961	...	6,35,71,426
1934-35	56,94,820	52,33,74,607	...	5,40,64,802
1935-36	40,19,262	37,35,59,955	...	57,40,862
1936-37	30,11,036	27,84,61,129		
1937-38	17,66,817	16,33,18,129		
1938-39	23,87,647	23,26,02,068		
1939-40	41,55,343	44,64,30,422		
Total ...	4,37,13,429	2,82,52,38,069		14,77,25,129

Before the outbreak of World War II, as is obvious from the statistics given above, exports of silver had ceased but those of gold had not abated. It is said that *exports of gold were due to a rise in its prices.* The value of gold is fixed in dollars by U. S. A. which, being the country holding the largest stocks of precious metals, is in a monopolistic position. With the abandonment of gold standard, sterling fell in terms of dollar and hence gold, and as rupee was linked to sterlling this also fell in terms of dollar and gold. After some time dollar was also devalued. Hence, ever since the pegging of sterling in terms of dollar, sterling or rupee has not appreciated in terms of gold. Depreciation of a currency in terms of gold means the same thing as a rise in the prices of gold. The prices of gold would have not risen had rupee been kept linked to gold at the old parity.

The first question in connection with the export of gold is whether, it was 'distress gold' or 'investment gold.' Truly speaking *it was both.* Gold was sold to make both ends meet, as far as poor people were concerned. But it was sold to take profit as far as rich people were concerned.

Advantages of gold exports. (1) Gold exports enabled the country to maintain *a favourable balance of accounts,* and their quantity was small compared to the vast reservoir of gold built up in years preceding 1931.

(2) They enabled the Government to *obtain large quantities of sterling* and to pay off the sterling debt of £15 million which matured on January 1, 1932.

(3) They also enabled the Government to *meet Home charges and to reduce the floating debt of India* in London.

(4) The *credit* of the Government was improved in foreign markets because of the facts mentioned in (2) and (3) and the rates at which it could borrow were substantially lowered.

(5) Less of gold enabled *the cancellation of sterling debt*

which had been accumulated at a time when more of gold would have been required to pay it off.

(6) *The position of the reserves* was strengthened. As a result of the exports of gold, balances in the paper currency reserve had mounted to enormous figures even before the war.

(7) They strengthened the *rupee sterling exchange* in particular and sterling in general.

(8) They stimulated the *foreign trade* of the country. Imports of gold were enabled to have increased[2] purchasing power, which they utilised[3] in purchasing Indian goods and this stimulated the exports of the country. Indian sellers of gold were also enabled to have increased purchasing power, which they utilised in purchasing foreign goods and thus stimulated their imports.

(9) They allowed the sellers of gold *to get higher prices* which they used in tiding over temporary financial difficulties. Those using the proceeds for investment purposes supplied capital to Indian industries.

(10) It was also pointed out that the future price of gold was uncertain. It might fall[4] at any time. But sterling appreciated.[5] Hence, *investment in sterling was better* than investment in gold.

Disadvantages of gold exports. (1) India parted with *an appreciating metal* for a depreciating currency, and the loss thus incurred was far in excess of any interest that was earned due to investments. This is true both of the individuals and

2 It is doubtful whether import of gold into America increased the purchasing power of the people in America. Gold imported into America was sterilised, and not used as the basis of increased currency,

3 During this period foreigners tried to place restrictions on their imports It is doubtful if they utilised their increased purchasing power if any in purchasing foreign goods.

4 The prices of gold have never fallen since then.

5 Sterling has been depreciating again and again.

the Government. The individuals acquired rupee Which lost in value. The Government acquired sterling.

(2) King Gold was not dethroned for ever. Even in the present currency system it has its high place. During World War II Reserve Bank of India purchased it at a very high price.

Possible remedy. The possible remedy, under the circumstances, was *acquisition of gold by the Government.* It could have parted with as much of it as was necessary to meet sterling obligations and retained the rest. This would have increased the gold reserves of the country.

4. Government's sales of silver

Though nothing was heard of exports of silver in comparison with those of gold since the abandonment of gold standard, the figures given above show that the former were also enormous. The cause in this case was also the same, and there was no abatement of exports of silver so long as its prices did not fall. But exports of silver were not alarming in comparison to its sales by the Government from 1927. Sales of silver were undertaken *in pursuance of the recommendations of Hilton Young Commission.* It had recommended the notes to be declared inconvertible into rupee coins' and hence also ended the need for the maintenance of big silver reserves. We know, however, that no legislation was passed declaring notes inconvertible into rupee coins. But the Government began selling silver, and upto 31st March, 1934, had sold a little over 196 million fine ounces or about 57 crores of rupees. Sales of silver depressed the price of silver and also caused deflation of currency.

In July of 1933, there was made *an International Silver Agreement* which bound the Government of India to sell not more than an average of 35 million ozs. annually for four years, *i.e.*, from 1st January, 1934 to 31st December, 1937. On the other hand, the governments of U. S. A. Australia, Canada, Mexico and Peru promised to purchase an equivalent amount. went a step metallic further in 1935. It undertook to buy silver until its silver stocks constituted 25% of its reserves and until the price of silver touched 64d. per ounce.

i.e., about Re. 1/8 per tola, Immediately after the passing of the Act, when the Government commenced operations, the price rose to 36·25d. per ounce. Had this policy been continued, the effect would have been to bring rupee to a melting point. China, finding it difficult to maintain her silver currency, had to give up silver standard. The Government of India also got one rupee notes printed to provide for the contingency. But the occasion for putting these into circulation did not arise, as the Government of U. S. A. reversed its policy, and the price of silver receded back to the low level of 20d. in 1936 and remained between 16d. and 23½d during 1936-41. The Government of India, however, continued selling silver from time to time both in Bombay and London.

5. Exchange rate during 1931 to 1932

We know that prices had begun to fall in India as everywhere else in 1929. This had its effects upon her balance of trade as well. India's exports consisting mostly of agricultural commodities and imports mostly of manufactured goods, it declined greatly. In 1933-34 there was a slight improvement. But next year again there was a deterioration. Then, for two subsequent years again there was an improvement. But the year 1937-38 again witnessed a change. Since 1938-39, again the position improved. During the first year of war, there was of course a fall in both exports and imports, but the balance of trade was not affected. Since the second year, however, both exports and imports and balance of trade as well improved.[1]

It may be pointed out that *the fall in the balance of trade had the tendency to weaken the exchange rate*. But this was *maintained because of the continued exports of precious metal* and specially gold. From April 1938, however, the effects of falling exports and increasing imports began to be visible; and the exchange rate began to fall and reached a point lower than 1s. 6d. in the first week of June of that year. On June 6, the Government issued a communique notifying its determination and capacity to maintain the exchange rate and this had

1 This is true only as far as the value is concerned and not quantity.

a steadying effect. But the rate did not rise higher than 1s. $5\frac{1}{1}\frac{5}{8}$d. for the time being. In December, forward exchange rate weakened and the Government again issued a communique. During the last quarter of 1938-39 there was an improvement in the balance of trade and exchange rate which went up to 1s. $5\frac{3}{3}\frac{1}{2}$d. in March, 1939.

The demand for a lower exchange rate had been pressed since 1931. *The arguments advanced in this connection* may be briefly stated as follows :—

(1) When after the I war, the currencies of different countries were reorganised, their value was fixed at or below the pre-war level. But unfortunately in the case of Indian currency, it was fixed above it. It is said so often that the United Kingdom had to face industrial and financial setback during the years between 1925 and 1931 only because it had restored sterling at the prewar level. At the end, it had ultimately to decline it as it could not bear the burden any longer. India being no exception, her industrial and financial position was hit to the most due to this over-valuation. *Consequently, it gave a setback to her industries and employment figures continued swelling.*

(2) Prior to September, 1931, maintenance of rate had been made possible only by resorting to *artificial devices* and then uptill the out-break of the World War II *gold exports* helped the Government to maintain it.

(3) There is no doubt that after the divorce of sterling from gold, rupee was also devalued in terms of latter and other currencies to the same extent as the former. But the weightiest reason for the devaluation of rupee, *viz*, undoing of the injustice done to rupee by fixing it above the pre-war level after the I war remained unremoved. Besides *rupee remained overvalued in terms of sterling*, and most of India's trade being with sterling countries, she suffered in competition with them.

(4) Of course 18d. ratio became as sacrosanct as 16d. ratio after being in force for a very long time and prices, wages and contracts had all adjusted to it in the meantime. But there was

no harm in causing disturbance to these, if it was expected to be beneficial as a whole. The main ground on which the question of ratio should be decided must in all fairness be dependent upon the fact *whether a particular ratio will be beneficial to the country in the long run or not.*

(5) It was pointed out by those, opposed to devaluation that devaluation of rupee would lead to *competitive devaluation*. This was really very strange. France had devalued her currency at least thrice without caring for others. What is India or rupee in the scheme of world finance that others should have taken notice of it ? Even if they would have done so, where was the harm ? India did not check them from doing what they had liked in the past.

(6) The upholders of 18d. ratio said that the advantages of devaluation was bound to be only *temporary*. The answer to their argument is, but that would have been enough for the country.

(7) It was also said by some that devaluation could not help exports as foreigners would have imposed high tariffs against them. But people abroad are not so foolish. India's exports were largely in demand in manufacturing countries of the world and surely they were only too happy to get their requirements. Even countries importing our manufactured goods would not have done so as they had no industries to protect. Besides, *the main aim of devaluation is not to encourage exports but to discourage imports*, and if that was achieved any setback to the former could not be felt because of the increased demand of the country itself.

It was expected that devaluation would result in giving stimulus to both the country's internal and external trade and manufacturing and agricultural industries. This would have surely solved *the question of unemployment*. In May, 1938, the Chief Ministers of the Congress-governed provinces resolved to secure the co-operation of all the provinces to send representations to the Government of India for devaluation of rupee. This was a significant move. The matter was taken by the Indian National Congress as well, which passed a comprehensive resolution on the subject on December 14, 1938.

SUMMARY

1. During the period 1927-39 agitation centred at first mainly round exchange ratio and then round exchange rates and gold exports both. Besides, the crisis of 1931 brought out the real characteristic of Indian currency. From 1927-29 trade conditions in India were favourable, and the supporters of 1s. 6d. rate pointed out that the country did not suffer on account of this. But those against it pointed out that a lower ratio would have communicated the improvement to Indian trade in a greater measure. Next, during this period the Government had to resort to artificial devices to strengthen the exchange rate. After 1929, India became involved in world trade depression. The contraction brought about during the previous period to maintain the exchange rate made the matters still worse.

2. Britain had adopted after the I war gold standard at a pre-war parity, and this factor alone was in the absence of any other responsible for the deterioration in the condition of its trade and industries. The crisis of 1929 made the matters still worse. In the end, in September 1931, it had to give up gold standard. In India also there arose the question whether she should remain on gold standard or adopt sterling exchange standard. The Executive after a suspension of four days decided in favour of the latter. The alternative to a link with sterling in consequence of the adoption of sterling exchange standard were a link with gold and a free rupee and both of these positions would have proved to be detrimental to the interest of the country. Coupled with other consequences of the step taken, the most important was the continued export of gold. It was only after the outbreak of the World War II that this abated due to the imposition of war-time restrictions and other causes.

3. India had always been in normal years prior to 1931 importing precious metals. Since September 1931 till the outbreak of World War II it had, however, been exporting them and specially gold. The immediate cause of this situation was a rise in their prices. The Government and some of the people also claim that the export of gold was to the advantage of the country. But the fact is that it would have been better had the Government purchased a considerable portion of it instead of allowing the whole to be exported.

4. The continued sales of silver as well by the Government was not in the interests of the country.

5. During the period 1931-39 also the exchange rate could be maintained only because of the exports of precious metals and specially gold. Demand for a lower exchange rate continued to be pressed all through this period as well. Arguments advanced in this connection were that it gave a setback to Indian industries, that it could be maintained only because of the continued exports of gold, that

rupee remained overvalued in terms of sterling in comparison with pre-war level, that the question of ratio should be decided mainly upon the ground whether a particular ratio will be beneficial to the country in the long run or not, that India should not care for what other nations would say if she devalued her currency, that she did not mind even if the advantages of devaluation were to be only temporary, and finally that she wanted this not to encourage exports but to discourage imports.

TEST QUESTIONS

1. What arguments were advanced by the supporters of 1s. 6d. ratio and its opponents during the period 1927-31 in consequence of the conditions existing in this country at that time ?

2 What were the reactions of the divorce between gold and sterling in India ? Do you think that the step taken thereupon was a right course ? Give arguments for your answer.

3. What arguments were advanced by the Government and its spokesmen against the 'linking of rupee to gold' ? Mention the consequences of its stabilisation in terms of sterling.

4. What led to the exports of gold during the years 1931-39 ? Do you justify them ? If not, suggest your alternative.

5. Was there any sanction for the sale of silver by the Government of India after the recommendation of the Hilton Young Commission ? What is your own opinion on this step ?

6. What was the condition of the exchange rate during 1931-39 ? Examine the case of 18d. exchange value of rupee as against 16d. exchange value.

7. Write a short essay (not exceeding four pages of your answer book on Indian currency during 1931 to 1939.

CHAPTER IX

PAPER CURRENCY IN INDIA

Indian paper currency has a long history behind it, dating as far back as the 18th century. We have, of course, made a passing reference in the previous chapters of some of the steps taken in this connection. But there is a need of discussing it here in a greater detail and in a coherent manner. This can be done by dividing the whole period into certain distinct stages, each with its own characteristics and leading to the other.

1. Period I (up to 1861)

Up to the year 1861, notes were issued by the three *Presidency Banks and a few other private banks.* Their circulation was practically confined to the three Presidency towns. They were *not legal tender.* By far the most important of these were those of only the Presidency Banks whice were allowed by their charter to issue notes in all up to the maximum amount of 5 *crores of rupees* against which they were to hold *one-fourth in specie.* The causes of their limited circulation were *firstly* absence of legal tender characteristic in them and *secondly* absence of facilities for their conversion into rupees at a distance from the Presidency towns. It was perhaps not thought proper at that time to make them legal tender, *as the Government could not take any responsibility of their conversion.* Besides, facilities of their payment into specie or coins was not available because of the *difficulties of communications.*

2. Period II (1861 to 1941)

In the year 1861, after a good deal of hesitation and careful consideration the Government by virtue of an Act passed in 1861 *deprived all banks* of the right of note-issue and provided for the issue of a paper currency through a Government department by means of notes payable to bearer on demand. It divided the whole country into three *circles of issue, viz.,* Calcutta, Madras and Bombay and notes issued from the headquarters of any of these circles were *legally encashable* only at their respective headquarters. Later on, as paper currency increased in circulation more circles[1] were created, the total number reaching seven at the end. For the accommodation of the public, however, the notes of other circles could be encashed at any paper currency office at any Government treasury, provided such encashment could be done without any inconvenience. In the first instance, they were, therefore, made *legal tender* as well within the area of their respective circles. Had the notes been made universal legal tender but only encashable at the headquarters of their respective circles, they would have been placed at a discount at certain times of the year and this would have impaired their popularity.

The Act also required that a metallic reserve, called the paper currency reserve, be kept against the whole of the notes issued, with the exception of such amount not exceeding 4 crores of rupees as might be fixed by the Governor-General-in-Council with the consent of the Secretary of State for India. This amount was to be invested in Government securities. This was, in fact, an imitation of the principle of the English system or *Fiduciary Issue System* or Currency Principle of note issue.

The first notes issued were of the denominations of Rs. 10, 20[2], 50, 100, 500, 1,000 and 10,000,

Subsequent changes. The subsequent changes during the period under review were as follows :—

(*1*) *Increase in gross circulation.* In the beginning the gross circulation of notes was small, but gradually it increased. The average of 1862-63 was Rs. 3'69 crores ; that of 1890-1, Rs. 15'77 crores ; that of 1900-1, Rs. 28'88 crores ; that of 1906-7, Rs. 45'14 crores ; that of 1911-12, Rs. 57'37 crores ; and that of 1912-13, Rs. 65'69 crores.

(*2*) *Introduction of 5 rupee notes.* 5 rupee note was introduced in 1891. It became suitable for payment of small

1 Additional circles were those of Rangoon, Karachi, Kanpur and Lahore.

2 Rs. 20 notes could not be very popular, and hence, were discontinued in 1910.

sums. It was perhaps on this account that the average gross circulation increased after this very rapidly.

(3) *Universalisation of notes.* The circle system greatly restricted the normal expansion and popularity of notes. The first step was, therefore, taken in 1903 *to abolish it,* when 5 rupee note was made universal legal tender except in Burma. In 1909, it became so in the latter place as well. In 1910, notes of the denominations of Rs. 10 and 50 were similarly universalised, and power was taken to universalise notes of higher denominations by Executive order. In 1911, accordingly, Rs. 100 note was universalised. This also had its effects upon the increase in gross circulation.

(4) *Increase in fiduciary portion.* Changes were also made in fiduciary portion. Additions were made in 1881 to the extent of Rs. 2 crores ; in 1891, to Rs, 1 crore ; in 1892, to Rs. 1 crore ; in 1897, to Rs. 2 crores ; in 1905 ; to Rs. 2 crores, and in 1911, to Rs. 2 crores. Adding to these Rs. 4 crores allowed by the Act of 1861, the total reached Rs. 14 crores.

(5) *Investment of fiduciary portion in sterling securities.* Of the fiduciary portion mentioned in (4) a sum of Rs. 2 crores was allowed to be invested in sterling securities in 1905 and of another Rs. 2 crores in 1911.

(6) *Changes in the metallic portion and its location.* Before the closing of mints to free coinage of silver, the metallic portion of the paper currency reserve was held in silver coins, (1) By the Act of 1893, currency notes were issued in exchange for gold coins or bullion to any amount, and hence the metallic portion of the paper currency reserve also began to be held in silver coins and gold coins and bullion as well. (2) By the Gold Note Act of 1898, notes were also allowed to be issued against *gold deposited in London* with the Secretary of State. This was intended as a temporary measure to remove the stringency in the money market. In 1902 it was made permanent. *Finally,* the 1905 Act allowed the metallic portion of the paper currency reserve to be held in rupees, gold coins and bullion either in India or London and fiduciary

portion in rupee and sterling securities (the latter only to the extent of Rs. 2 crores).

(7) *Changes in the use of paper currency reserve.* Paper currency reserve was originally meant for the *encashment of notes.* In the Gold Note Act of 1898, however, there was included a clause authorising the Government to use gold held in the paper currency reserve *for the purchase of silver for coinage.* This was in the beginning intended to be a temporary measure, but was made permanent at last in 1902. From 1905 gold held in London and sterling securities held there also began to be used *for the support of exchange* and reverse councils issued in India began to be paid out of both the gold standard reserve and paper currency reserve without any distinction of any sort. On the other hand, both paper currency reserve and gold standard reserve (its rupee branch) were used for the purpose of conversion of notes into rupees as well. It was because of these arbitrary uses without keeping any distinction in mind for the purposes for which the two reserves were kept that the Hilton Young Commission recommended their unification which was ultimately brought about by the transference of the note issuing business to the Reserve Bank of India in 1935.

Chamberlain Commission. Chamberlain Commission pointed out that Indian paper currency system was inelastic. It recommended the following for making it more elastic:—

(1) The *fiduciary portion should be raised* at once to Rs. 20 crores and thereafter be fixed at a maximum of the amount of notes held by the Government in the Reserve Treasuries plus one-third of the net circulation.

(2) The Government should take power to make *temporary investment* out of the fiduciary portion mentioned both in India and London. The practice of thus lending money temporarily would result, it held, in the following advantages:—

(a) Such temporary loans would help the money market and relieve the seasonal monetary stringency specially in India.

(b) The Government would be able by such loans to earn a considerable profit.

(c) It would be able, as the note circulation would increase, to add to the fiduciary portion without any legislation. This was because of the adoption of the percentage system as recommended in (1).

(d) The temporary investment in London would help the Secretary of State to sell council bills against paper currency reserve in anticipation of silver purchased without causing any loss of interest as in the case when gold is 'earmarked' by him for that purpose. In fact, the Commission did not favour the holding of gold in paper currency reserve in London earmarked for the purchase of silver.

Besides, the Commission wanted to popularise notes, and for this purpose it recommended the granting of extra facilities for the *encashment of notes*. It recommended the universalisation of 500 rupee note as well.

The Commission also recommended that the gold held in India in the paper currency reserve should be made *available* in normal times to the public in exchange for notes. But when exchange fell, it was to be made available only on condition that it would be immediately *exported* out of the country to meet trade requirements.

The Secretary of State was according to it not to hold gold worth more than £5 million in the paper currency reserve. This along with its sterling securities would, it was pointed out, serve as a final source for securing the convertibility of notes in an internal crisis in India. Moreover, it was also expected to be used as a second line of defence in case exchange showed any sign of weakness.

But before the Government could take any action on their recommendations the war broke out and everything else was postponed.

3. Period III (War I and Babington Smith Commission)

(1) It has already been said that during the first few months of the outbreak of war, *the active circulation of notes fell down but after some time it began to increase and reached*

a very high figure. The total note issue was almost trebled by 1920.

(2) The difficulty of obtaining sufficient quantities of precious metals as backing for the issue of additional notes made it necessary to *increase the fiduciary portion* of the reserve. By various Ordinances and Acts of the Legislature, the limits were raised from Rs. 14 crores prior to war to Rs. 120 crores by December, 1919.

(3) Of the fiduciary portion, Rs. 6 crores were invested in *British Treasury Bills* according to an Act passed in 1916. This was raised to Rs. 100 crores by the end of December, 1919.

(4) Prior to the war, steps were being taken to give greater and greater facilities for the encashment of notes. But the policy had to be *reversed* from 1916 owing to the shortage in metallic reserve and silver for coinage purposes. As a result the facilities for the encashment of notes at district treasuries were in a large degree withdrawn. The *transmission of rupee coins* by rail or river steamer or post office was also prohibited. In connection with the supply of coins a sort of *rationing* system was also resorted to. The net effect of all this was a discount in notes of as high as 19 per cent in several places.

(5) To encourage the use of notes in small payments, *Rs. 2/8 notes were introduced in 1917 and Re. 1 notes in 1918.* In fact, it was because of this step taken by the authorities that the active circulation of notes increased specially during and after 1917.

Babington Smith Commission. The essence of the recommendations of the Babington Smith Commission as that of the Chamberlain Commission was to give greater elasticity to note issue. But the question of the composition of the paper currency reserve also being under discussion recommendations of the Commission related to this as well.

(1) It recommended the adoption of the *Banking principle*

of note-issue in place of the currency principle so far adopted. The fiduciary portion was not to exceed 60 per cent of the gross circulation in any case.

(2) With a view to meet the *seasonal demand* for additional currency, it recommended the issue of Rs. 5 crores worth of notes to the three Presidency Banks on the security of export bills having a maturity not exceeding 90 days. Something like this had been recommended by the Chamberlain Commission as well. But there was one important difference, *viz.*, while according to the recommendations of the Chamberlain Commission, this additional issue was to form a part of the fiduciary portion laid down, according to the recommendations of the Babington Smith Commission, this was to be over and above the fiduciary portion laid down.

(3) It allowed the retention of the securities to the extent of Rs. 120 crores in the fiduciary portion of the paper currency reserve only *temporarily*. But ultimately this was to be in accordance with the recommendations contained in (1).

(4) Of the fiduciary portion in the paper currency reserve, the holding of securities issued by the Government of India could not exceed Rs. 20 crores. The remainder was to consist of securities of other governments within the British Empire, redeemable at a fixed date of which all except Rs. 10 crores worth were to be *short-dated securities* maturing within one year.

(5) The metallic portion of the reserve was required *to be held in India* except for transitory purposes.

4. Period IV (1920-1935)

As soon as the report of the Babington Smith Commission came out, and reverse Councils began to be sold in order to maintain the rate of exchange recommended by it, the Secretary of State felt the need of making their payment out of the proceeds of the sterling securities in the paper currency reserve. But in accordance with the existing legislation, rupee securities could not be held in India for a larger amount than already permitted, and hence it would have become necessary to cancel the notes to the same extent. To avoid this, *a temporary legislation was passed* in March, 1920, continuing the then existing figure of Rs. 120 crores as the limit of permissible investment, but abolishing the restrictions as to the location of the investments and their sterling or rupee character. The Act remained in force up to the 1st October of the year, when it was replaced by the Indian Paper Currency Amendment Act of 1920.

Indian Paper Currency Amendment Act of 1920. This Act provided for the issue of currency notes against gold coins and bullion at the *new rate.* Besides, it accepted the *banking principle* of note-issue in place of the currency principle followed till then. According to it the metallic portion of the reserve was to be not less than 50 per cent of currency notes in circulation instead of 40 per cent as recommended by the Babington Smith Commission. Of this, gold held by the Secretary of State could not exceed Rs. 5 crores. As regards the fiduciary portion, it laid down that the Government of India rupee securities held at that time to the extent of Rs. 85 crores could be held only for a transitional period. In the end, however, they could not be held for more than Rs. 20 crores. Then, inasmuch as a result of the revaluation of gold coins and bullion and sterling securities at the new rate, there was bound to be caused a huge loss to the paper currency reserve, it was allowed to be made up by the issue of a special creation of the Government of India rupee securities which were christianed as *'created' or 'ad hoc' securities.* But they could not be permanently held for an amount exceeding Rs. 12 crores which was also to form a part of the permissible limit of the Government of India rupee securities. The revaluation was to result in a loss of more than this amount, and hence, it was enacted that as long as the 'created' securities exceeded Rs. 12 crores, they could be held as a part of the fiduciary portion of the reserve and that too of the permissible limit of the Government of India rupee securities and gradually they were to be written off out of the interest derived from the securities in the reserve with effect from the 1st April, 1921.

The interest on securities held in the gold standard reserve and profits on coinage also were to be utilized for the same purpose when the gold standard reserve reached £40 million. It may be said that during the years that followed, the provision of utilizing the interest on securities in the reserve towards writing off created securities was suspended. *Finally,* they were reduced by valuation at 1s. 6d. after the acceptance of the recommendations of the Hilton Young Commission to that effect.

The Act also provided for the *issue of emergency currency* against bills of exchange. It laid down that loans be given to Imperial Bank of India only when the bank rate rises to 6 per cent., and when the bank rate is below 7 per cent., a maximum of Rs. 4 crores be used, when it is 7 per cent, another Rs. 4 crores and when it is 8 per cent., another Rs. 4 crores be used. During 1921-24, there was made contraction to strengthen the rate of exchange. This was, however, met by issuing an emergency currency as laid down above. Finally, in September, 1924, an announcement was made changing the rules under which loans were made to Imperial Bank of India from currency so as to make it possible for the Bank to borrow Rs. 4 crores when the rate was at 6 per cent and Rs. 8 crores when it was 7 per cent., instead of Rs. 4 crores at each rate from 6 to 8 per cent.

Paper Currency Amendment Act of 1925. This Act increased the permissible limit of the Government of India rupee securities from Rs. 85 to Rs. 100 crores provided that the total amount of 'created' securities did not exceed Rs. 50 crores.

Withdrawal of Rs. 2/8 and Re. 1 notes. Rs. 2/8 note was never popular, and its issue along with that of Re. 1 note was discontinued from January 1, 1926.

Hilton Young Commission 1926. Along with other recommendations, it made also those in connection with paper currency. So far, currency was controlled by the Government, and credit, as far as it was controlled, by the Imperial Bank of India. This Commission recommended the establishment of the *Reserve Bank of India* with (1) the sole right of note issue and (2) the power to impose upon the country a judicious credit policy.

As regards the paper currency reserve, it favoured the *proportional reserve system* for the country and laid down for the separation of the Issue and Banking Departments of the proposed Reserve Bank of India.

In the light of experience of other note-issuing banks which are working this system, it recommended the provision of gold and gold securities in the reserve to be not less than 40 per cent of the liabilities as a minimum which were to include the notes in issue plus Rs. 50 crores set aside as provision against conversion of the hoarded-rupees into gold. Of this, gold was ultimately to be at least 25 per cent of liabilities (to be attained by stages in 10 years) with a minimum of of Rs. 30 crores. As regards the remainder, rupee securities not more than 25 per cent liabilities with a minimum of Rs. 50 crores. Then, there were rupee coins to the extent of Rs. 85 crores. The Commission recommended their reduction to Rs. 25 crores in due course. It has already been said that it did not recommend the conversion of new notes into rupee coins and hence it thought that the demand for them would after some time be considerably reduced.

We already know that the Commission had recommended *the conversion of only old notes into rupee coins.* New notes were to be redeemable only in notes of smaller denominations —one rupee notes were also to be issued. But this does not mean that the notes were to be inconvertible. The whole of the Indian currency was made *convertible into gold bullion by the Hilton Young Commission.*

The recommendations of the Commission regarding paper currency could note be given effect to till the year 1935. In the meantime, gold securities in the paper currency reserve were revalued at the new rate.

Universalisation of Rs. *500 and Rs.* 1000 *notes.* Rs. 500 and Rs. 1,000 notes were universalised during 1931-32.

5. Period V (1935—up to date)

Establishment of Reserve Bank of India and changes *introduced in Indian paper cnrrency system.* Reserve Bank of India was established by the Reserve Bank of India Act 1935, and it began functioning from 1st April 1935, on which date it took over the management of the Currency Department of the Government of India by the erection of a special department called the Issue Department. The assets of the gold standard reserve and the paper currency reserve were combined and transferred to the extent of the liabilities assumed by it in respect of the notes issued[8] in the forms in which it was required to hold them in pursuance of provisions in the Act constituting it. The Bank also took over the duty of supplying the Secretary of State with sterling for his London requirements and maintaining the exchange rate. Besides, it holds all the balance of the Government of India, State governments and scheduled banks of the country and is a banker to all of them.

Since the taking over of the management of the Currency Department of the Government of India by the Reserve Bank, we have got bank issue of notes in this country instead of the Government issue which had been in vogue here since 1861. At the time of the commencement of the note-issuing function, however, the Bank did note issue its own notes. The notes of the Government of India issued and in existence at that time became the notes of the Reserve Bank of India. The Bank made in the meantime arrangement for the issue of its own notes and they were completed in 1938, in which year it issued them in denominations of Rs 5, 10, 100, 1,000 and 10,000. In view of the fact that the circulation of Rs. 50 and Rs. 500 notes was negligible, it did note issue its own notes of these denominations, though Government of India notes of these denominations continued to be legal tender. The notes of the Reserve Bank of India are legal tender throughout the country and guaranteed by the Government.

The liabilities of the Issue Department of the Reserve

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*The recommendation of the Hilton Young Commission that the assets should consist ofthe liabilities of the notes issued plus Rs. 5o. crores in lien of the lower intrinsic value of rupee coins in circulation was not evidently accepted.

Bank of India consist of the notes in circulation and those held in the Banking Department.

The assets in the paper currency reserve consist of gold coins and bullion and since India has become member of I. M. F., the securities of the member countries of the same and before it only sterling securities, rupee coins,[4] rupee securities of the Government of India and bills of exchange and promissory notes which the Bank is allowed to deal in. Of these till 1956 gold coins and bullion and foreign securities could note be less than 40% of the total with a provision that gold coins and bullion could not be held to the extent of less than Rs. 40 crores valued at 8,47512 grains per rupee at any time. In 1957 it was decided to change the system. Gold was revalued at the legal parity, *i.e.*, Re 1 equal to. 186621 grammes of gold and it was laid down that it shall not be worth less than Rs 115 crores. Foreign securities were to be worth not less than Rs 400 crores which figure was by a latter Act reduced to Rs 200 crores. The rest is allowed to be held in prescribed Government of India rupee securities, rupee coins and notes and prescribed bills.

Improvement effected by the above changes As a result of the issuing authority of notes from the Government to the Bank, the supply of currency can be kept more in accordance with its demand than it could be kept previously. The Bank, being in intimate contact with the money market, is in a position to know constantly more accurately and more quickly the day-to-day demand for it than the Government machinery being slow by nature could not be expected to move in this direction rapidly even if it could know the requirements so correctly and accurately. Moreover, Government policy of note-issue is guided by political considerations rather than by trade requirements. Bank's policy of note issue, on the other hand, is not guided by any other motive. But so far as the Reserve Bank of India is under the control of the Government, there is still a fear of this.[5]

1 Since June 1940, rupee coins include ane rupee notes as well.

5 In fact note circulation increased far in excess of trade requirements during World War II, and this resulted in a tremendous rise of prices as well.

Formerly there were two reserves maintained by the Government of India, *viz*, (1) the gold standard reserve and (2) the paper currency reserve. But in practice, there was, no demarcation between their functions. Hence, their unification had been recommended by the Hilton Young Commission. It was brought about only with the establishment of Reserve Bank. Of course, the Commission had recommended the holding of Rs. 50 crores in reserve over and above the liabilities of the Issue Department in lieu of lower intrinsic value of rupee coins in circulation. But this was not laid down in the provisions of the Reserve Bank Act, and hence the reserve is maintained only to the extent of the liabilities in the Issue Department. At the time of the transference of the assets of the Issue Department of the Bank from the Currency Department of the Government, the whole stock of gold in the paper currency reserve and the gold standard reserve was transferred to the Issue Department of the Bank. Besides, Section 36 (1) of the Banks' Act requires Government to pay full legal tender value for surplus rupees returned by the Bank under the provisions of that section. To meet this obligation the *silver redemption reserve* amounting to Rs. 10 crores was constituted by the Government with effect from 1st April, 1935.

The changes in the composition of the paper currency reserve have also brought out an improvement in the paper currency system in so far as it is more elastic now than it was previously. The Government of India could issue emergency currency on the recommendations of Imperial Bank of India only to the extent of Rs. 12 crores on the security of bills of exchange. The Bank, on the other hand, can issue it now to a much greater extent. This has not only made it elastic but also automatic. When notes are issued on the security of bills, money flows out of the Bank, but when they get matured it comes back to it.

Finally, before the establishment of Reserve Bank of India a portion of the paper currency reserve was held in England for purchase of silver. This discouraged the silver market of the country. With the establishment of the Reserve Bank, no portion is kept in England for this purpose and it was hoped that all silver purchases would be made in this country if need be. But since silver currency is not issued now the question of the purchase of silver does not arise for the present or future.

Reforms still necessary. Paper currency is exchangeable into rupee coins or notes of small denominations including those of rupee one since June, 1940. This means that one token currency is convertible into another or say it is wholly inconvertible. But this is the case all over the world.

Reserve Bank of India Balance Sheet Issue Deptt.

Liabilites	Rs.
Notes held in the Banking Deptt.	1078,07,000
Notes in circulation	1540,25,29000
Total Notes issued	1551,0136,000
Total Liabilities	1551,01,36,000

Assets	Rs.
A. Gold Coin and Bullion :—	
(a) Held in India	117,76,03,000
(b) Held outside India	Nil
Foreign Securities	245,53,81,300
Total of A	363,29,84,000
B. Rupee Coin	130,19,24
Govt. of India Rupee securities	1056,82,28000
Internal B/E, etc.	Nil
Total Assets	1351,01,36,000

SUMMARY

1. History of paper currency in India can be divided into different period. The first lasted up till 1861. During this period notes were issued by the three Presidency Banks and a few other private banks. They were not legal tender. The total issue of the three Presidency Banks was restricted to Rs. 5 crores only and one-fourth of this was to be kept in specie. They could not be made legal tender, as the Government could not take any responsibility of their conversion, and they could not be converted at all places due to the difficulties of communications.

2. In 1861, the Government assumed the monopoly of note issue. The whole country was divided into three circles which were later on increased to seven. Notes of one circle were legal tender only in that circle and convertible only at their respective head-quarters of the particular circles. It was at first a fiduciary system of issue Gradually, there was an increase in note circulation The lowest denomination of the notes in the beginning was Rs. 10. Rupees five notes were introduced in 1891. Rs 5 notes were universalised in 1903, Rs. 10 and Rs. 50 in 1910, and, Rs. 100 in 1911. The fiduciary issue was also increased from Rs. 4 crores to Rs. 14 crores between 1861 and 1911. Of the fiduciary portion mentioned above a sum of Rs. 2 crores was allowed to be invested in sterling securities in 1905. The remaining was to be invested only in Government of India rupee securities. The Act of 1893 allowed the metallic portion to be held in gold coins and bullion as well in addition to silvercoins. In 1898, the location of gold was allowed to be in London as well. The Paper currency reserve was in the beginning meant only for the convertibility of notes, but gradually, it began to be used for the purchase of silver for coinage and support of exchange as well. The Chamberlain Commission raised the fiduciary portion of Rs. 20 crores and gave the Government power to make temporary investments as well out of this in both India and London. Besides, it recommended the granting of extra-facilities for the encashment of notes. and universalisation of Rs. 500 notes as well. It also recommended for the giving of gold to the public in normal times in exchange for notes and when exchange showed a sign of weakness only on condition that it would be exported in payment to foreign countries. A limit was also placed upon the holding of gold by the Secretary of State in London. But the war broke out nothing could be done.

3. During the third period after a temporary fall, total note circulation increased tremendously. Along with it there was also an increase in the fiduciary portion. A part was also allowed to be invested in British Treasury Bills. The policy of giving facilities for the encashment of notes was reversed. Rs. 2/8 and Re. 1 notes were also issued. The Babington Smith Commission recommended the banking principle of note issue. It also recommended the issue

of notes so meet seasonal demands against bills Other recommendations of the Commission were of a temporary nature.

4. The fourth period began with the passing of a temporary legislation in pursuance of the Commission's recommendations of a temporary nature. Finally, Indian Paper Currency Amendment Act of 1920 was passed. It legalised the Commission's recommendations of permanent nature with small changes. Rs. 2 8 and Re 1 notes were withdrawn from January 1, 1920, Paper Currency Amendment Act, 1925, authorised a larger holding of the Government of India rupee securities. Hilton Young Commission recommended, (1) Bank issue, (2) Proportional reserve system, (3) Unification of the paper currency and gold standard reserves, and (4) Conversion of new notes into notes of smaller denominations and of the whole currency into gold bullion. Rs. 500 and Rs. 1,000 notes were universalised in 1931-32.

5. Reserve Bank of India was established in 1935 and took over the monopoly of note-issue business on April 1 of that year. On that date unification of the two reserves was also brought about, and the assets in the paper currency reserve were acquired in the form required by the Reserve Bank of India Act. A number of improvement have been affected by the transference of the business of note issue to the Reserve Bank.

TEST QUESTIONS

1. Give a short history of Indian Paper Currency system from 1861 to 1914. (Delhi).

2. What do you mean by elasticity ? How far did the recommendations of the Chamberlain Commission and Babington Smith Commission try to secure it ?

3. Bring out the special features of Indian paper currency system during the war of 1915-18. What important decisions were reached by the Babington Smith Commission in this respect ?

4. What was the system of note issue in India up to 1935 ? What changes were introduced by the Reserve Bank of India Act and why ?

5. What do you understand by elasticity of currency ? Briefly indicate to what extent elasticity has been secured in Indian currency system in consequence of the establishment of the Reserve Bank.

6. Describe briefly the changes introduced in Indian paper currency system with the establishment of the Reserve Bank of India, indicating the improvements effected by such changes. Is any reform still necessary in your opinion ?

7. Describe the existing system of paper currency in India, explaining the main items appearing in the weekly statement of the Issue Department of the Reserve Bank of India.

CHAPTER X

EFFECTS OF WORLD WAR II (1939—1945)

The commencement of the World War II on September 3, 1939, brought about inevitable dislocation in many spheres in India as well. We can study it under two heads, *viz.*, (1) immediate effects of war, and (2) permanent effects, and steps taken thereon.

1. Immediate effects of war (September 1939 to March, 1940)

First of all, *commodity prices* took an upward trend owing to the belief that the intensification of economic warfare meant brighter prospects for industries and agriculture. Calcutta index number of wholesale prices (1914 =100) advanced sharply from 100 in August, to 137 in December, 1939, being the highest since 1929. But in the following month, there was a fall owing to a general feeling that the initial rise had been over-done. It also became more generally realised with the publication of the Excess Profits Tax Bill that war profits would be objected to taxation.

Gold prices were also affected, and they moved erratically in an upward direction both in England and India. Hence, London Market had to be closed from the 2nd to the 4th September, 1939, and Bombay Market from the 4th to the 7th. On the 5th September, dealings in gold were prohibited in the United Kingdom under the Defence (Finance) Regulations; sterling was officially pegged to dollar at 4-02 to 4-06 and Bank of England fixed its buying price of gold at 168 S. at which it remained till June 9, 1945, when it was raised to 172s. 3d. In India, an *embargo was placed on its exports and imports* by an Ordinance of the Government except on the authority of a license granted by the Reserve Bank. The prices varied after that mainly on account of the forces of supply and demand, the net effect being a rise from about Rs. 37 per tola on the outbreak of war to about Rs. 100 per tola at the end of 1945.

Price of silver also rose due to the appreciation of dollar and speculative buying, ready price touching Rs. 63-12 on the 21st September. Price in London also reached $23\frac{1}{2}$d. on the 20th September, but the situation was eased by sales of spot silver for London delivery at $23\frac{1}{2}$d. for account of the Indian Government. In India, owing to increased supplies accompanied by a fall in up-country offtake the price declined to Rs. 56-2 on the 4th October. With a view to conserving foreign exchange, the British and Indian Governments announed respectively on the 26th and the 30th October, their decisions *to prohibit imports of silver except under license.* Thereafter mainly as a result of sharp upswing in commodity markets, prices continued to advance and touched Rs. 66-4 on the 1st December, on rumours regarding Goverment's intention to suspend the sales of silver for delivery at the Bombay Mint. It was announced on the 14th December, that thereafter the sales of silver for delivery ex-mint, Bombay, which till then had been conducted through London, would be conducted by the Bombay office of the Reserve Bank of India. As a result of this and other measures and the fact that the demand in India was more speculative than for genuine investment purposes there was a reaction and prices sagged. But finally they began to rise again, and reached Rs. 137 in August, 1945. After that there was a rise in prices in U. S. A. and U. K. as well, and as a result thereof there was again a rise in India also the new level being about Rs. 200.

Rise in the prices of *commodities* was also accompanied by an increased demand for them from allied countries. The result was that *the value of exports during the year 1939-40 rose* to Rs. 213,67 lakhs as against Rs. 169,35 lakhs of the preceding year. At the same time *the value of imports also rose* during this period to Rs. 164,72 lakhs as against that of Rs. 151,79 lakhs during the previous year.

India's internal trade also recorded an improvement during this period, and was the largest since 1933-34 when the publication of the statistics regarding it was begun. As a result of this, railway earnings also rose and were the highest since 1929-30, while the number of wagons loaded was the largest recorded since 1928-29.

On the outbreak of war the central government also delegated to the Reserve Bank authority under the Defence of India Ordinance to administer the regulations controlling dealings in coins, bullion, securities and foreign exchanges. On the 4th September, the Reserve Bank issued an explanatory memorandum to the public giving the general line of the control of foreign exchange transactions. *All dealings in foreign exchange were required to be transacted through authorised dealers* and the exchange banks and certain Indian joint stock banks were licensed as such. *No restrictions were placed on the purchase and sale of Empire currencies with* the exception of Canadian, Newfoundland and Hongkong dollars, while *the purchase and sale of non-Empire currencies was restricted to genuine trade purposes, travelling expenses and small personal remittances* The policy of exchange control was to ensure that all foreign exchange transactions in India were done on the basis of the rates quoted by London Exchange Control combined with the current rupee rate for sterling and authorised dealers in foreign exchange were informed that no business must be done by them outside these rates.

Finally, as during the war of 1914-18, at the outbreak of hostilities this time as well, the people began to *sell their Government securities, encash Post Office cash certificates and notes and withdraw deposits from banks including Postal Savings Banks.* This tendency was due to panic and became widespread soon after the enactment of the Emergency Powers Defence Act by the Government of the United Kingdom because rumours were current that the Government of India contemplated drastic measures for the control and confiscation of private wealth and property. The Government immediately and emphatically contradicted these rumours and public confidence was soon restored.

2. Permanent effects and steps taken thereon (The year 1940 and after)

It has already been said that after a rise in Calcutta index number during the first four months of the war, there had begun to come a fall. But after July. 1940, there began to be registered *a rise again* and it reached a mark of 245 by 1945. A mention has already been made of the rise in the prices of gold and silver. As regards *foreign trade* as well, it may be said that though the gains for the beginning were neutralised during the year 1940-41 specially because of the loss of European markets, control of imports and exports and scarcity of freight, they were again made up in the following year and *continued to increase*—specially the exports. The price level of both imports and exports rose in almost equal degree. Trade with sterling group of countries continued unhampered by exchange restrictions and recorded a significant rise alike in respect of exports and imports. The most striking increase in India's trade outside the Empire was with the United States, both the imports and exports registering a rise. The rapid rise in imports from Japan since the beginning of the war was stopped by the freezing of Japanese assets in July 1941.

Government Securities. With the outbreak of hostilities there arose a desire to sell Government securities, and their prices continued to fall for some time with certain interruptions, of course. On the 26th June, 1940, the Board of the Bombay Stock Exchange had to *fix minimum prices* for them. Next, the Government of India, by an order issued under the Defence of India Rules on the 2nd March, 1942, had to do the same. On the 14th March, 1942, the order had to be extended to Provincial Government securities as well.

Post Office Cash Certificates. During the first month of the war, while the repayment of Post Office Cash Certificates increased enormously, their sales declined sharply. But gradually the former went down and the latter rose up. Total amount outstanding, however, went on going down up till the year 1942-43 as also from the year 1936-37. After 1943-44, it again went up.

In early June of 1940, however, 10 year Defence Savings Certificates with a higher yield were introduced. Their net receipts during 1940-41, 1941-42, 1942-43 and 1943-44 amounted to Rs. 229 lakhs, Rs. 206 lakhs, Rs. 121 lakhs and Rs. 141 lakhs. They were replaced by 12 year National Savings Certificates from Oct. 1, 1943, their net receipts for 1943 44, 1944-45 and 1945-46 being Rs. 8,65 lakhs. Rs. 19,54 lakhs and Rs. 9,032 lakhs respectively.

Encashment of notes. Prior to June, 1940, rush for encashment of notes was not great, it being less than a crore of rupees per week, but with the collapse of France in that month it increased and suddenly rose to Rs. 4 crores a week. In that month, however, free encashment of notes was stopped and a sort of rationing system was introduced in important places. Besides, one rupee notes were introduced, and these began to be exchanged for notes of higher denominations.

Absorption of Currency. Absorption of note currency went on during the war. It was Rs. 35,43 lakhs for the first 7 months, i.e., till 31st March 1940. Since then it was enormous and reached Rs. 121,654 lakhs (upto March, 1946). Absorption of rupee coins as well during the first 7 months of war was Rs. 19,53 lakhs. This was due to encashment of notes and rise of a new demand because of the impetus given to trade and industry by war. Since then, it was Rs. 13,934 lakhs including Government of India rupee notes also upto March, 1946. Absorption of small coins was also till then for about 70,83 lakhs.

Craze for hoarding rupee coins. Demand for rupee coins for hoarding increased in January, 1940, and was accentuated towards the last week of May, 1940, on the news of French reverses, and turned into a scramble in June when the Reserve Bank had to part with Rs. 15·12 crores of rupee coins; and from the 15th June to the end of August, there was a record return of notes to the extent of Rs. 21·93 crores. The authorities continued to issue coins, and their holding in the Issue Department of the Reserve Bank which had stood at Rs. 78·87 crores on the 1st September, 1939 fell below the statutory limit of Rs. 50 crores by the 24th March, 1940 and was further reduced to Rs. 35·1 crores on the 21st June. Some action was necessary to deal with a situation under which the mints working at full pressure could not replace the coins disappearing from circulation and which involved great inconvenienee to the public and danger to the community. The withdrawal from circulation of over 40 crores of units of value from the credit structure of the country threatened a dislocation of trade and slump in prices.

On the 25th June, therefore, the Government of India promulgated a rule under the Defence of India Act making it an offence for any person to acquire coins in excess of his personal or business requirements. Earlier on the 10th of June, an amendment of sub-rule (2) of rule 90 of the Defence of India Rules had prohibited refusal to accept coins or notes in payment of a debt or otherwise. While the notification of 25th June succeeded in its objective of reducing the total demand for conversion of notes, its immediate effect also was to intensify the demand for smaller units of value and a special measure had to be taken to cope with it. In Bombay, Rs. 50 in rupee coins and Rs. 10 in small coin were regarded as ordinary individual requirements, and indents up to that limit were met in full, while in Calcutta Rs. 50 for an individual and Rs. 500 for a business firm were considered as the maximum to which rupee coins could ordinarily be issued. In Calcutta, as in Bombay, larger banks and leading business houses were supplied with their demands in full. In Bombay, arrangements were further made with the 30 Scheduled banks having their offices in the city to give rupee coins and small coins up to the maximum of Rs, 50 against currency notes. Special facilities were also offered by the Reserve Bank by opening 6 small change depots on the 4th July and 4 more on the 5th at the principal markets. These depots worked till the afternoon of Saturday, the 13th July, when rush subsided and demand for coins declined.

Government of India one rupee notes. Scarcity of a unit of exchange smaller than the lowest denomination of notes was acutely felt as a result of the hoarding of rupees. Government accordingly issued an Ordinance on the 24th of July providing for the issue and putting into circulation of Government of India one rupee notes with immediate effect. We know that such notes had been printed in 1935 to provide for a contingency which, however, did not asise at that time. It may be mentioned that they were also introduced during World War I in December 1917 with a view to economising the use of silver, and had attained a considerable popularity.

Reserve Bank of India two rupee notes. Reserve Bank of India issued two rupee notes as well early in the year 1943 with a view to reduce the demand for rupee notes and coins which had been rising very rapidly.

Reduction in the fineness of siver coins. The Indian Coinage (Amendment) Ordinance issued on the 26th July, 1940 reduced the fineness of the half rupee, and the Indian Coinage (Third Amendment) Ordinance issued on the 23rd December, 1940, that of the whole rupee from 11/12 ths of fine silver to one-half of fine silver. In view of the increasing simultaneous demand for half rupees and whole rupees, it was felt that it would be wasteful to turn out large quantities of these coins of the old fineness. It was also felt that this reduction of fineness would discourage their hoarding as well. The new rupee coin was milled on the edge with a serrated or upright milling in the centre of the milled edge, there was shallow grove with a design inside in two sections separated by blank spaces, and the design inside the grove consisted of alternate beads and diagonal lines in relief. No rupee coin was minted between 1922 and 1940. From 1940 to 1945, approximately 104 crores rupee coin were minted, of these only 98 lakhs being of 11/12th fineness the rest being of 50 per cent fineness. From 1835 to 1945 approxiately 750 orores of rupee coin were minted in all.

Withdrawal of silver coins. In exercise of the power conferred by the Indian Coinage (Second Amendment) Ordinance, promulgated on the 11th of October, 1940, the Finance Department Notification called in with effect from the 1st of April, 1941 all rupee and half rupee coins bearing on the obverse the effigy of Her late Majesty Queen Victoria, and directed that on and from that date, these coins should cease to be legal tender except (1) at the offices of the Issue Department of the Reserve Bank at Bomby and Calcutta until further notice, and (2) at any Government treasury or post office till the 30th September, 1941. Apart from improving the quality of coins in circulation, an object of the Ordinance was to recover the coins from uneconomical hoarding. Next, with a view to replace the silver coins by the King George VI coins with the security edge in order to minimise the use of silver for coinage purposes and also to discourage counterfeiting, the Finance Department Notification dated the 4th of November, 1941, called for the King Edward VII rupees and half rupees as well from circulation. They were declared to cease to be legal tender afrer the 1st of May, 1942, but to continue to be accepted till the 30th of September, 1942 at Government treasuries, post offices and railway stations and thereafter, until further notice, only at the Offices of the Issue Department of the Reserve Bank, Bombay, Calcutta and Madras. Finally, according to a Notification of 1942, George V and VI silver coins of 11/12th fineness were also called for.

For some times past, because of a rise in the price of silver, it however, became profitable to retain them. In fact, they began to command a higher value as bullion than as coin, and hence commanded premium. This is the position even now.

Issue of small coins in a nickel brass alloy. With a view to meet the demand arising out of wartime activities, the Government of India issued in January, 1942, a new half-anna coin which economises metal and is convenient to the public. Further, with a view to economising the use of nickel, it was decided to mint the new half-anna piece and the one anna coin in a nickel brass alloy instead of the cupro-nickel alloy. The nickel brass is composed of 79% copper, 20% zinc and 1% nickel.

Shortage of small coins. During the later months of the year 1942, actute shortage began to be felt in small coins in general and one pice bits in particular. Hence, their hoarding was declared to be illegal. Besides, the standard weight of the two-anna, one-anna, half-anna and quarter-anna (or price) was reduced with effect from January 28, 1943 to 90, 60, 45 and 30 grains troy respectively.

Post Office Saving Bank. Withdrawals from and deposits into Post Office Saving Banks followed war developments. The amounts outstanding at the end of the years 1938-39, 1939-40, 1940-41, 1942-43, 1943-44, 1944-45 and1945.46 were Rs. 81'94 orores, Rs.78'38 crores, Rs, 59'57 crores, Rs,52.13 crores, Rs. 52'28 crores, Rs. 64,24 crores, Rs. 80.28 crores and Rs. 113,93 crores, respectively. With a view to encouraging people of limited means who wished to invest their savings so as to assist the war, a new scheme of Post Office Savings Bank accounts known as the *Indian Post Office Defence Savings Bank* was announced and came into operation from April 1, 1941. The principal feature of the scheme was that the deposits were repayable not on demand but a year after the war, the rate of interest on them, having been fixed at 2½ per cent, free of income tax, *i.e.*, per cent higher than the rate on ordinary Postal Saving Bank accounts. Finaly, its scope was further extended by a provision in the Indian Finance Act, 1942 under which an option was offered to assessees under the lowered exemption limit for income tax to deposits in the Defence Savings Bank one rupee for every Rs. 25 by which his income exceeded Rs. 750.

Repatriation of sterling debts. Large acquisition of sterling as a result of the growing favourable balance of trade enabled the Reserve Bank to put considerable amounts at the disposal of the Government of India. Desirability of repatriating sterling debt had been constantly before the Government and the Reserve Bank, and a beginning had been made in 1927, but it had to be temporarily discontinued owing to the slackening of Government's remittances. However, during this period, the Government completely liquidated its liabilities on account of the Family Pension Funds and transferred to England to the extent of £9½ millions in this connection. Next, as soon as possible, it took the opportunity provided by the availability of sterling to reopen the former scheme by which the Reseve Bank was authorised to purchase *non-terminable* Indian sterling securities in the open market as and when they became available and tansfer them to the Government for cancellation. In their place, additional Rupee paper. the 3½% and 3% non-terminable loans, was created up to the same nominal value. The first such cancellation was effected on the 15th November 1939 and it was continued throughout the year. After this, the scheme for the repatriation of *terminable* loans was announced by the Government on the 22nd of February, 1940. It consisted of the creation of rupee loans as counterparts of the Indian sterling loans. Then, early in 1941 *the above scheme was replaced by a more comprehensive scheme of repatriation* in order to accelerate the process with the help of the accumulated sterling resourcess with the Reserve Bank. On the 8the February, 1941 Government announced that they had with the cooperation of the British Government taken action to *acquire the bulk of India's terminable sterling debt* of the face value of £84 million and a market value of approximately £90 million. The British Treasury issued on the 7th February, 1941 a vesting order requiring all residents in the United Kingdom to surrender their holdings of India's terminable sterling loans at prices fixed on the basis of the market price as on the 7th February, 1941 plus an allowance for the period necessary to examine surrendered documents before making payment. The Government of India issued a notification to the same effect on the 8th February, 1941 under the Defence of India Rules, requiring residents in British India to surrender their holdings of these sterling loans, payment being offered at their option in rupee counterparts or cash. The rupee finance required for the operation was found by Government from its balances supplemented by a ways and means advance from the Reserve Bank and by the sale of the rupee counterparts to the Bank. To enable the Bank to hold the additional rupee securities thus created, the Reserve Bank Act was amended so as to remove the restriction on the maximum amount of rupee securities which it could hold in its Issue Department. The option given to the residents in British India to receive rupee counterparts in payment of the surrender of their holdings of terminable sterling loans was availed of to the extent of Rs 10·22 crores. Finally, the Government announced on the 24th December, 1941 that it had taken action *to acquire as far as possible the whole of its remaning debt* other than railway debenturea and stocks, etc). A year's notice was given by the 'Secretary of State to holders of 3½% sterling stock which was to be re-paid on January 5, 1942. There remmained two more stocks after this and the British Treasury issued a Vesting Order on the 23rd December, 1942 requiring all residents in the United Kingdom holding either of these loans to surrender them by the 9th February, 1942 to the Treasury at prices based on the market prices for the day plus an allowance for the inevitable delay involved in examining the scrips before making payment. It was also announced that payment subject to good delivery would be made from the 2nd March, 1942. The Government of India issued a similar order requiring residents in British India to surender their holdings of these sterling loans at prices equivalent to those fixed in the U. K. order referred to above converted into rupees at 1s. 6d. The payments under the British and Indian Vesting Orders commenced on the 2nd March and continued throughout the year, sterling payments being effected by the transfer of sterling treasury bills from the issue to the Banking Department of the Reserve Bank and rupee payments by the creation of ad hoc treasury bills in the Issue Department, which were gradually cancelled.

The whole of the sterling debt of £276 million or Rs. 368 crores outstanding at the end of 1936-37 was thus wiped off. The Finance Member, during his speech while introducing the budget for the year 1943-44, truly said that India had compeleted the transition from a debtor to a creditor country and extinguished within the brief space of about 3 years accumulations over decades of its public indebtedness to the United Kingdom.

Paper Currency Reserve. With an increase in note circulation, a corresponding increase was brought about in the paper currency reserve as well. Besides this, as has already been observed elsewhere, (1) rupee coins include now one rupee notes also, (2) the limit to the holding of rupee securities to the extent of Rs. 50 crores or 1/4 of the total reserve which ever was less originally prescribed in the Reserve Bank Act does not stand, and (3) gold holdings in London were cancelled by a transferenee of the gold holdings of Bank of England with the Reserve Bank to the paper currency reserve. Finally, the percentage of the holdings of sterling securities in the paper currency reserve went up due to India's favourable balance of trade and purchases made and expenses incurred by the Government of India on behalf of His Majesty's Government A portion was utilised in the cancellation of sterling loans as noted above. But even then, it increased with a tremendous rapidity, and become a source of embarasment to the country. As against this, it may be said that with an increase in note circulation, gold holdings in the reserve being fixed, their percentage to total note-issue went down. But the point of satisfaction is that while its market value went up, its book value stands at the old level, and if we take it up at the market value, the percentage rises much above what it appears to be.

Government of India Defence Loans. The loan programme of the Central Government was carried on under the Indian Defence Savings Movements first announced on the 4th June, 1940, and took various forms including Defence Savings Certificates and Post-office 'Defence Savings Banks referred to previously. It was, however, not so successful as it ought to have been mainly because of political reasons. Further, on May 17, 1943, an Ordinance was issued, according to which all except six and two-thirds per cent of excess profits was usurped by the Government in the form of loans. Attempts were also made to raise loans from the agriculturists as well out of their increased earnings due to the increased prices of agricultural commodities.

Additional Taxation. The war brought home the necessity of additional taxation as well. The Supplementary Finance Bill, 1940 imposed a 25% surcharge on all taxes on income and increased letter postage, telegram and telephone charges. After this enchancement of old taxes and imposition of new ones went on very year till the cessation of the hostilities.

Bank Deposits. Though in the beginning, heavy withdrawls of bank deposits were noticed, as time passed on and confidence was restored, demand and time liabilities of bank went on increaaing.

Exchange Control Restriction Control of foreign exchange transaction continued to be exercised by the Exchange Control Department of the Reserve Bank of India through the medium of the authorised dealers. Sterling area, however, continud to expand or contract accoding to war developments. As regards 'hard currencies', i.e,, the currencies of non- Empire countries but not those of the eaemies or occupied by them, Bank of England had fixed rates at which it bought and sold them. But this was only for dealings in the United Kingdom and other Empire countries Rates in the outside markets for sterling known as 'free markets' fluctuated widely and at one time, it was quoted at a discount. Now, owing to this discount on sterling in New York, it became ultimately more advantageous to sell Empire imports to the United States, or to other 'hard currency' countries, on a sterling basis than it was to sell the goods on a foreign currency basis as the foreign importer was able to buy sterling cheaply for his imports in 'free' sterling markets. India also took advantage of this difference in rates and the bulk of Indian shipments to the United States for the first few months of the war was financed through the medium of sterling bills drawn by the importers in the United States on London. Hence, rupee-dollar transactions had to be forbidden at other than the basis of the official London rates, and by an agreement with American banks, the rupee rate in New York was quoted on the same basis as the dollar in India, and no 'free' market in rupees was allowed to develop. In order to put a stop to the loss of foreign exchange caused by the finance of Empire exports in 'free' sterling in other countries, Bank of England introduced at the end of March 1940 an export control system covering certain commodities whereby their export to 'hard currency' countries was not allowed unless the shipper produced satisfactory evidence that he was receiving 'hard currency' and not sterling for the shipment. Similar restrictions were placed in India and elsewhere. In India, the commodities affected were jute and rubber. Later on their shipment was allowed only if a further assurance came that the 'hard currency' so received would be handed over to the Reserve Bank and through it to the Bank of England. In June, 1940, this export control scheme was extended to cover all commodities to U. S. A. and Swizerland.

An interesting result of the new regulations was a large increase in the volume of exports financed by bills in foreign currency and the fall in those financed under London sterling credits. This was accentuated by the suspension of air mails to London after the collapse of France. Hence, Reserve Bank of India announced its decision to purchase foreign currency from Indian exporters at rates based upon those fixed by the Bank of England.

As the war developed and the strain on U. S. dollar resources of the Empire became heavier, further measures were taken to conserve foreign exchanges. The Government of India in May, 1940 introduced a system of import control and licensed the import of certain commodities from certain countries. This was later on extended to all commodities. Restrictions on remittances for other than trade purposes were also increased In December, 1940, the Government took over U. S. dollar holdings of all residents in British India and their rupee equivalents were paid out by the Reserve Bank. Similarly, on March 10, 1941, the holdings of residents in India of certain U. S. dollar securities were acquired. Finally, all notes of Bank of England with residents in this country were requisitioned.

With the extension of war to the Near East, the Japanese Government imposed restrictions on the drawing of bills in sterling or on places west of Bombay against exports from Japan. The result of this was that importers in the Middle East were forced to make their purchases of Japanese goods through Bombay. A large entrepot trade in Japanese goods thus developed in this country, and measures had to be taken to ensure that India was not called upon to provide foreign exchange for which she received no corresponding return.

In July, 1941, orders were issued freezing the balances of all Japanese companses and firms residents in India. On the outbreak of hostilities with Japan, the assets of Japanese companies and firms in India including those of Japanese banks became vested in the custodian of the enemy property.

Besides several other orders were issued from time to time with the main object in view, but we cannot make at this stage a detailed study of all of them.

Rise in prices and control exercised by the Government. It has already been observed that the initial rise in prices stopped in March, 1940. But after some time, there was again a change. A number of causes are attributed to it but the most important is increase in the supply of currency. Profiteering and speculation only intensified the tendency.

Just after the outbreak of the war, the Government received many reports to the effect that prices of many articles of necessity had gone considerably high. There was nothing to justify this specially in a number of cases. The Defence of India Ordinance, and the Defence of India Rules drawn up thereunder had empowered the central government to make provision for controlling the prices at which articles or things of any description whatsoever could be sold. Further, these powers could also be delegated by the central government. Hence, provincial governments were authorised by a notification dated the 8th September, 1939 *to fix limits to the extent of the rise of prices* at each stage of the productive and distributive process, in the case of necessities and in particular of medical supplies, foodstuffs, salt, kerosene oil and the cheaper quality of cotton cloth. The minimum price in each case was not to be less than 10% above the prices ruling on September 1, 1939. All the provincial governments took immediate action.

Controllers of Prices were appointed at headquarters of each district. In the beginning, Deputy Commissioners and Collecters in charge of districts were empowered to act as local controllers. But later on, in many places, there was felt the necessity of the appointment of whole-time staff. Both the Provincial and the District Controllers began to be assisted by Advisory Boards of Price Control Committees.

The Government of India also convened a number of *conferences* of the representatives of all provincial governments and administration in India *to discuss questions connected with price control.* They were very useful in chalking out programmes of common interest.

Rationing of supplies. With a view to make arrangement for a fair distribution of the necessaries of life a number of rationing schemes were introduced. In certain cases they proved to be of immense benefit to the people concerned.

Receipt of silver under lease and lend agreement. Steps were taken to obtain silver from the United States Treasury under Lease and Lend Agreement on condition of its return on an ounce to ounce basis within 5 years of the official announcement of the cessation of hostilities.

Sale of Bullion by the Reserve Bank of India. Reserve Bank of India sold both gold and silver in Indian markets at different times and different rates mainly with a view to arrest the expansion of currency, the sales of gold during the period 1943-44 to 1945-46 amounting to 7·5 million ounces, and those of silver during the period 1939-40 to 1945-46 amounting to 18 million ounces

Gold was obtained from South Africa and sold first of all on behalf of the British Government and later on on behalf of both the British Government and the South African Government. This was, however, objected to very much by responsible Indians. Gold was commanding a very high premium in this country, and they said that the Reserve Bank of India was helping the foreigners in the act of profiteering The best course was for the Bank itself to purchase gold and sell it in India on its own accounts.

Demonetisation of High Denominational Notes.[1] With a view to discouraging black market operation and tax evasions the Government of India demonetised in January, 1946, notes of the denominations of above Rs. 100. It was, however, provided that a non-scheduled bank could exchange them at the Reserve Bank or a scheduled bank for value in one hundred rupee notes or for credits with the Reserve Bank. Similarly, scheduled banks and Government treasuries could obtain for them value in one hundred rupee notes or in deposits with the

* Since April 1, 1954 again Reserve Bank of India has commenced issuing Rs. 1,000, Rs. 5,000 and Rs. 10 000 denomination notes.

Reserve Bank. Other holders of these could also get them exchanged at the Reserve Bank, a scheduled bank or a Government treasury on their presentation and a declaration in the form prescribed within a fixed period. Although the bulk of the demonetised notes aggregating Rs. 109,66,91,000 were exchanged immediately applications for exchanges continued to be received for long. The total value of high denominational notes exchanged up to the 31st March, 1946 was Rs. 123,36,52,5000.

It may be said that this step of the Government of India was unprecedented. It was a bombshell. The Times of India editorially remarked that even the atomic bomb with all its applications created less of sensation when news of its detonation first reached India than the first repercussions of the Demonetisation Ordinances. The Free Press Journal of Bombay wrote that it was opposed to all canons of jurisprudence, national and international law and was a blend of blackmail and day-light robbery, and an act of gangsterdom.

The Government notification justified it by declaring that the working capital of black market operations was believed to be held in large measure in the form of high denominational notes and the Government were aware of the persistent public demand for effective action against black marketeers who were first class enemies of public welfare. It expected to book them as well as tax-dodgers and thought that no inconvenience would be caused to ordinary honest citizens. But this was not to be. Black-marketing, rather a new kind of black-marketing in these very notes sprang up for some time. Tax-dodgers because of the influence they wielded with the Government officials and by offering them bribes continued evading taxes quite all right. On the contrary honest citizens who had their hard-earned savings in the form of these notes were put to great inconvenience and in certain cases due to the shock administered to them by this step of the Government suffered a loss of money and here and there of their lives as well. The net effect of it, it may be said was loss of faith in currency and a rise in the value of precious metals and hoarding habit.

SUMMARY

1. Effects of the war of 1939-1945 can be studied under the heads of immediate and permanent. Immediate effects lasted till March, 1940. They included an upward trend in commodity and bullion prices, increase in the value of both exports and imports and internal trade as well, exchange control, sale of Government securities, encashment of post office cash certificates and notes and withdrawal of deposits from banks including postal saving banks by the people.

2. Then there are the following permanent effects and steps taken thereon.

(1) After an initial rise in prices, there was a fall in them. But after sometime, they began to rise again, and this time permanently.

(2) The gains of the beginning in the foreign trade were neutralised during 1940-41. But soon there was a rise specially due to the increase in prices and demand from allies.

(3) Fall in prices of Government securities continued, hence control had to be exercised. Minimum prices of the securities of both central and the provincial governments had also to be fixed.

(4) Total amount outstanding of the post office cash certificates continued to decline. 10 year Defence Savings certificates were however, introduced, though they were not very popular.

(5) Rush for encashment of notes increased in June, 1940, and steps had to be taken to discourage it. Re. 1 notes were introduced in the same month. Later on two-rupee notes also came in circulation.

(6) Absorption of currency notes, rupee coins (these now include Re, 1 notes as well) and subsidiary coins—continued to be great In the beginning, there developed a craze for hoarding rupee coins. Hence, soon after, steps had to be taken to check it, · Ruduction in the fineness of silver coins had also to be undertaken to economise the use of silver and discourage hoarding.

(7) With a view to bring about (1) an improvement in existing currency, (2) an economy in the use of silver and (3) discourage hoarding, silver coins of 11/12th fineness were withdrawn gradually beginning from those bearing the effigy of the Queen Victoria. They were deprived of their legal tender characteristic with this end in view.

(8) With a view to economise the use of nickel, small coins were issued in nickel-brass alloy instead of in a nickel-cupro alloy.

(9) Shortage of small coins compelled the Government to declare their hoarding as well illegal. Further, a reduction was also made in their weight.

(10) The amount outstanding of the post office savings banks continued to fall. A new scheme of these, however, known as the Indian Post Office Defence Savings Banks was announced. Further, its scope was extended by allowing the assessees under the lowered exemption limit from income tax to deposit in the account Re. 1 for every Rs. 25 by which his income exceeded Rs. 750.

(11) The scheme of repatriation of sterling debts of the Government of India introduced in 1937 but suspended thereafter had to be revived in order to reduce and check the holding of sterling balances of the Reserve Bank of India in consequence of a great rise in the country's favourable balance of trade and in the expenditure incurred by the Government of India on behalf of His Majesty's Government in connection with the financing and carrying on the war-operation.

(12) Changes were brought about in the composition of the Indian paper currency reserve by including one-rupee notes in the category of rupee coins, withdrawing the limit to the holding of rupee securities as laid down in the original Act, and cancelling gold holding in London of the issue Department of the Reserve Bank by a transference of gold holdings in India of the Bank of England to the paper currency reserve. It may also be said that the percentage of holding of sterling securities in the paper currency reserve went up in spite of the undertaking of the scheme of repatriation of sterlingdebts.

(13) New loans were issued by the Government of India to finance war and check inflation, though they were not as popular as they ought to have been.

(14) Additional taxation was also levied with these ends in view.

(15) Bank deposits were on an increase.

(16) Exchange control was exercised more and more vigorously.

(17) Government exercised control over prices with a view to check an warranted rise in them. For this purpose, it appointed Controllers of Prices, and called a number of conferences to devise ways and means to be more successful.

(18) Rationing of supplies of certain articles was also undertaken.

(19) The Government received silver from U. S. A. on the basi of what was known as Lease and Lend Agreement.

(20) The Reserve Bank of India sold both gold and silver with a view to arrest inflation—gold on behalf of the foreigners who made profits at the expense of this country.

(21) High denominational notes were demonetised in January, 1946 with a view to bock black-marketeers and tax dodgers. But the object was not achieved. Rather it shook confidence in currency, increased prices of precious metals and encouraged hoarding.

TEST QUESTIONS

1. What were immediate effects of II War on prices, trade, exchange and people in India? Discuss these in brief.

2. Give in short the difficulties experienced by the government and the people of this country during II War and the steps taken thereon to alleviate them.

3. Write short notes on the following;—repatriation of sterling debts, exchange control restrictions, price control, hard currencies, free markets for purchase of sterling and rupees, rationing scheme, demonetisation of high denominational notes,

CHAPTER XI

Post-War II Period

The expectation that the commodity prices would fall and their supply would rise as soon as the war terminated did not materialise. Instead general index number which was 244·1 in August, 1945 rose gradually to 409·7 by 1950-51.

Causes of Post-War Inflation

1. *Expantion of Currency and Credit.* The Government continued spending on behalf of the British Government till June, 1946, even though the hostilities had ceased, and in consequence thereof note currency issued on the strength of sterling securities went on increasing day by day. After June, 1946 as well note currency has been increasing but now due to the necessities of the Government itself and hence, without the backing of the sterling securities.

2. *Budget deficites.* The budgets of both the Central and the Provincial Governments showed deficits and hence they took the refuge of the Reserve Bank of India which met the situation by issuing more and more of notes. The deficits were due to several causes, *e.g.* the rehabilitation problem and the scarcity of food and raw materials arising as a result of the partition of the country, war in Kashmir, police action in Hyderabad, establishment of embassies in various countries.

3. *Decontrol.* After the termination of the war, the demand for decontrol strengthened. Mahatma Gandhi also supported it. Hence, in December, 1947 control was lifted from food and cloth. The effect was not at all wholesome. General Index Number of prices rose, and in the end control had to be levied again in October, 1948.

4. ***Food Scarcity.*** **On the one hand the population had increased and on the other, the wheat-producing area of**

Punjab and the rice-producing area of Bengal had been lost to the country due to the establishment of Pakistan. Besides, as a result of the improvement in the economic condition of the poor people, they consumed wheat and rice in place of coarse grains. Hence, these had to be imported from outside India.

5. *Industrial Crisis.* After World War II, the industries of the country witnessed a sort of crisis. On the one hand the prices of the raw materials rose, and on the other, the labourers demanded higher and higher wages. Strikes were being organised all over the country. Again, because of the over-working of the machines during war period, they needed renewal and replacement which could not be made possible as they were not available in many countries and from others they could not be imported as we did not have the necessary currencies to import them.

2. Effect of Post-War Inflation

Effect of post-war inflation was different from that of the war-time inflation During war, though the prices of all the goods rose, those of the manufactured goods rose higher still. The result was that the industrialists and the traders were very much benefited. The profit arising out of the increased prices of agricultural commodities as well went to the traders rather than to the farmers. The wages of the labourers did not rise with that rapidity with which prices rose. Hence, they fell in difficulty. As against this, the farmers and the labourers had awakened by the time the war terminated. The former got the benefit of higher prices and the latter that of higher wages. On the other hand, the industrialists did not get raw materials and if they got they lost because of the increase in prices, the scarcity of capital goods, rise in wages, strikes and control by Government on profits, etc. The condition of the middle classes was still worse.

3. Attempts at the arrest of Inflation

Finding the situation getting out of hands, the Government made attempts at the arrest of inflation. After consulting the industrialists, the banks, the economists, etc. of the country in October, 1948 they formulated a disinflationary plan. This included re-imposition of control on the prices of food, clothing and other articles of necessities, balancing of budgets by levying more taxes and reducing expenditure, raising production, placing a limit on company dividends and inspiring investment habits amongst the farmers and the labourers. All this bore fruit, but Korean war, stock piling programme of U. S A. and rearmament programme of European countries did not allow full control over the situation.

4. Beginning of Slump Period

Even then prices fell near about 1951. This was due to both national and international causes. Amongst international causes the main was declaration of truce in Korea. Besides the period of rearmament programme of European countries and stock-piling programme of U. S. A. was extended. An international raw material conference was called and steps were taken to solve the problem of non-availability of raw materials and increase their production. Amongst national causes the chief was the revision of import policy. Import licenses began to be issued easily and export duties were enhanced. Side by side there was registered a rise in production in the country itself. The Government budgets also showed surpluses. Bank rate was increased and the policy of open market operations was resorted to. This reduced the credit circulation as well. But sometimes the Government policy changed and thus prices registered rise, though the net result was a fall in them.

5. Devaluation of Rupee

In 1949, International Monetary Fund sanctioned a devaluation of pound sterling by 30·5 per cent. This was accompanied by currency devaluation in several countries. Rupee was also devalued in gold and dollars to the same extent. As a result of this, prices rose again for some time. Pakistan did not devaluate Pakistani rupee. Hence, imports from Pakistan also become dearer. The value of our sterling assets also fell and that of our debts from I. M. F. rose in terms of Indian rupees.

Had rupee not been devalued ; Indian exports to sterling area countries would have become dearer and ultimately dropped. On the other hand, imports from them would have become cheaper and hence risen. Of course, Indian exports to dollar area countries would have remained the same and hence we would have earned more dollars. Imports from them would also have remained the same. Some people said that this would have been in the interest of the country. But things would not have been so smooth. We would have had to face the competition of imports in dollar area countries from sterling area countries. Besides, we are more dependent on the countries of sterling area, and hence we have to go with them. We should certainly lessen our dependence on them in future.

When rupee was devalued, our Prime Minister, Pt. Jawaharlal Nehru declared that the external value of the rupee fell, it would have no repercussions on its internal value. But this was wrong. In consequence of the reduction in imports from dollar area countries on the devaluation of rupee it was natural for a rise in their prices. It can be said that we could import these goods from sterling area countries but this was not so. We could not get them there to our likings. The rise in the prices of other goods in sympathy with those of the goods of dollar area countries was also natural. Thus devaluation of rupee resulted in rise in prices. The imports from dollar area countries becoming dearer, they were reduced. As far as they were required for the establishment of new industries, this suffered. Some goods were concerned with our development programmes. But all these effects were short-lived. The effects of devaluation are always so.

Anti-Congress element of the country took advantage of the situation. They said that this went to prove that we were still dependent on U. K. Independence has still to come. But they were wrong. Had the Government of India so decided, they would not have devalued rupee. The Government of U. K. could not force them to do so. Neither they had any advantage in doing this. But even now our economic situation is such that we have to go along with the U. K. Many other countries as well are in this position.

Pakistan did not devaluate its currency. They could show they followed neither U. K. nor India—they were really independent. But their economic position was such that this was possible. Their balance of trade was in their favour.

All this resulted in the stoppage of trade between India and Pakistan. But in 1951, they had to come to an agreement and India accepted Pakistani rate of exchange. This was followed by the acceptance of the same by I. M. F.

We could, however, devaluate our rupee less. This would have been perhaps more in our interest and had we done so and consulted Pakistan, perhaps they would have also acted in the same way. The necessary consequence of devaluation is expansion of currency.

Shri Zahid Hussain, the Governor of the State Bank of Pakistan gave this very argument against devaluation of Pakistani rupee. We had inflation in this country and our Government made attempts to arrest it but without much success.

6. Sterling Balances

Though India had sterling balances for long, but during war period, they changed in form. In the beginning they were maintained to meet home charges, purchase silver and stabilise our exchange rate. But during war period, they were maintained for different reasons. Now the Government of India purchased in this county on behalf of allies and spent in other ways. The payment for all this was made in sterling. Hence, the Government transferred these sterling assets to the Reserve Bank of India and took Indian currency in its stead. In consequence of this note currency as well as sterling assets went on rising day by day. Sterling balances arose out of the following channels :—(1) Purchases by British Government of Indian raw materials and foodstuffs, (2) expenditure incurred by Indian Government according to Defence Expenditure Programme, (3) acquisition of dollars arising out of India's favourable balances with U. S. A. in empire dollar pool, (4) favourable balances of trade of the country, and (5) compulsory acquisition of other foreign assets in India than dollar and sterling in empire dollar pool. From the above, it is evident that a greater part of these acccumulated as a result of the political pressure of the British Government over India and compulsion. Later on, quite a good portion of this was utilised in redemption of our loans from U. K. or settlement of our other liabilities to them. But even then, on the termination of the war, we had quite an appreciable amount of these to our credit. Hence, arose the problem of their payment. It may also be said in this connection that some British opinion was in favour of repudiation. American opinion also seemed to favour this. Britain had turned into a debtor country because of the war. She had lost almost the whole of her income from overseas investments. Her economy depends upon imported food and raw materials and hence she must build up a large export trade which she could not, if left to herself specially because she had accepted the principle of free trade by agreeing to become a member of the I. M F. It was, in fact, at the request of the U S. A. that the U. K. had agreed to join the fund and hence the former thought that it must help the latter. She had granted her a loan and was prepared to sacrifice a part of her debt provided other creditors including India also did the same.

As regards the arguments advanced for India's cancellation of at least in part of her sterling balances they were as follows:—(1) the financial settlement apportioning war expenditure in India between U. K. and India left off India too lightly with the result that India, a poor country turned overnight from a debtor country into a creditor country. (2) These expenses were incurred as much in the defence of India as in the defence of U K. (3) India had already undergone sacrifices in their accumulation and it was not fair on her part to ask for compensation on this account from U. K. (4) U. K. had purchased her supplies in India at inflationary prices. (5) Rupee-sterling rate was kept at a very high level taking into consideration the fall in the internal value of the rupee, and had this not been done, the accumulation of these balances would have been considerably lower.

Now as regards (1) the financial settlement, it had been arrived at between the representatives of the United Kingdom and India after a careful consideration of all the factors based specially upon the recommendations of Chatfield Commission, and to say that it was in any way unreasonable to the former was more than any one could believe. If it could be unreasonable at all, it could be for India whose representatives were not the representatives of the people. Taking (2) these expenses were incurred as much in India's defence as in the defence of U. K., the fact was that India had already borne more than what was necessary in connection with her defence. No part of the expenditure incurred for the defence of India was borne by U. K. Rather India provided at all times a force approximately by strength of one division for operations outside her frontiers. She spent in the latter years of war as much as Rs. 1 crore per day which was sufficiently enough taking into consideration her requirements and position. As regards (3) the fact of India's having already undergone the sacrifices, it could be said that she had made them when it was needed of her. Now when she wanted money for her economic development, she had every right to ask for compensation from the country on whose account they were made. They meant under-nourishment of her people and deterioration in their already low living standard. Something was to be done now to raise it, and the least that she expected of the country on whose account she had to suffer was to help her by repayment of these in her recovery. Coming to (4) purchases at inflationary prices, it must be understood (1) that inflation had not been brought about in any way due to India's economic conditions, and she had to suffer on this account as much as any other country and (2) that the prices that U. K. paid were controlled prices and in certain cases much lower than the prices in U. K. itself for similar commodities and services. Finally, with regard to (5) keeping of the rupee-sterling rate at a high level, it must be said that the exchange rate does not depend only upon price levels. Demand for Indian products being high enough during war, rupee sterling exchange rate would have also risen up. In fact, the probability is that the exchange value of the rupee would have been higher still.

Taking above facts into consideration it may be concluded that there was no ground whatsoever for the cancellation of any part of India's sterling balances. The question was what form this payment could take and when it could be made. As regards the first, the form of payment, U. K. had neither gold nor goods. India wanted capital goods immediately and these U. K. could not offer at that time. India could not accept consumers' goods. This would have been detrimental to her industries. But consummers' goods were received and in several ways they were reduced. They could be repatriated by U. K's foreign assets. She had them in India as well. But this was not to be.

Hence, five agreements were entered into in this connection one by one, and no problem of payment of sterling balances remains now.

(1) The first was arrived at in January, 1947. According to this, we could meet our requirements from sterling area countries. But if we required we could get hard currencies as well.

(2) The second was arrived at in August, 1947. This was, in the first instance, for the period up to September but later on it was extended up to the period for June, 1948. Sterling balances, were now divided between two accounts—current and fixed. Current account was opened with a balance of Rs. 86.6 crores and fixed with that of Rs. 1466.6 crores. The balance in the current account could be drawn any time. Dollar and other hard currencies could, however, be secured only to the extent of Rs. 3 crores. Afterwards, on the partition of the country, Pakistan's share was transferred to her accounts.

(3) Third agreement was arrived at in July, 1948. According to this, military stores left in India were purchased by Indian Government for Rs. 133 crores. Secondly, an annuity for payment of the pensions of Britons retired from Indian Government services was purchased for Rs. 224 crores. Thirdly, the balance in current account with a further addition

of Rs 107 crores could be drawn within a period of three years. How much of this could be drawn in dollars and other hard currencies was left to the circumstances in future. Fourthly sterling securities worth Rs. 267 crores were regarded as backing for notes issued. Thus sterling balances of Rs. 1040 crores were left.

(4) Fourth agreement was arrived at in July, 1949 and was for the period up to June, 1951. According to this, after deducting Rs. 10.8 crores drawn from the fixed account till then, dollars worth Rs. 66·6 crores could be drawn each year for a period of two years. It was also agreed upon that the payment for food imports for orders placed before July, 1949 would also be made out of this account. Afterwards, on the devaluation of sterling, 30·5% less dollars were available.

Thus on February 8, 1952, sterling balances to the tune of only Rs. 857 crores were left.

(5) Fifth agreement was entered into in February 1952 for the period till 30th June, 1957. According to this 3·5 crores of sterling, *i.e.*, nearly Rs. 46 crores were transferred each year from the fixed account to the current account and was available for expenses. Besides 31 crores of sterling, *i.e.*, nearly Rs. 400 crores were transferred from fixed account to current account to remain as a backing for note currency and to be drawn only in case of emergency. After the lapse of 5 years, the balance remaining in the fixed account was proposed to be transferred to the current account and this has since been done.

From the above, it is quite clear that sterling balances have almost all exhausted. They have been used in the development of the country to only a small extent, if any.

7. Sterling Area Dollar Pool

During war period convertibility of sterling in dollars had been stopped. Hence, it was decided that the dollar income of British Empire countries be pooled into an Empire Dollar Pool from which expenditure could be incurred first of all in connection with carrying on the war and afterwards on the requirements of each country after their careful consideration. In 1947, it was decided as to what amount of dollars could be drawn by India Government every year from this account. It was also decided that in future all their earnings would be spent by them independently of the Pool. Consequent on India becoming a republican country and as countries outside British Empire are also its members, the pool is now designated as Sterling Area Dollar Pool instead of Empire Dollar Pool.

SUMMARY

1. Inflation continued even after the termination of war. Upto June. 1946 Indian Government continued spending on behalf of the British Government. This resulted in the increase of both sterling securities and note currency. After this defcit budgets could be balanced only out of expansion of currency. In December 1947 controls were lifted which also resulted in a rise of prices. One of the causes of inflation was food scarcity. Production of manufactured goods had also gone down.

2. Inflation during war period had been beneficial to industrialists and traders. The benefit arising out of increase in the prices of agricultural produce was secured by traders. The wages of the labourers as well did not rise in accordance with the rise in the price-level. But post-war inflation benefited the farmers; and the labourers also secured higher wages. As against this the profits of the industrialists fell; the prices of raw materials had risen; the wage bills of the labourers had gone up; strikes were being organised; machines had been worn up; devidends had been sealed. Middle class people were in a still worse condition.

3. In October. 1941, the Government called a conference of industrialists, banks and economists. It was decided that budgets be balanced; controls be reimposed; agriculture and manufactures should be given a fillip; dividends be sealed; investment habit be encouraged amongst peasants and labourers etc. In consequence of these; the price level did fall in the first instance, but again due to Korean war, stock piling programme of U. S. A., and rearmament programme of European countries, the price-level registered rises.

4. In April, 1951 again prices fell. Sometimes they rose, but, ultimately there was a continued fall. Korean war came to an end U. S. A's stock piling programme also slackened and rearmament programme also witnessed a setback. Indian Government issued import licenses more liberally, export duties were increased, production also rose up, budgets showed surpluses, bank rate was

raised, open market operations were resumed, etc.

5. 1949 witnessed devaluation of sterling in gold and dollar. Other currencies related to sterling also followed suit. Rupee was also devalued to the same extent. Of course, Pakistan rupee continued to be on the same level. As a result of this, trade between these two countries remained suspended for some time. Devaluation resulted in making imports from dollar area countries secure, encouraging exports to them and rise in prices. But all this was short-lived.

6. India had her sterling balances. But during war period they changed in form. The causes for their increase were—(1) purchases by British Government in India. (2) defence expenditure, (3) convertibility of our favourable balances of trade with U. S. A. in sterling (4) favourable balances of trade of the country, (5) conversion of our foreign assets into dollars and then pooling them into Empire Dollar Pool, etc. Later on India's sterling debts were repatriated out of these. Even then after the war, there remained quite a good amount of our sterling balances. From 1947 to 1952, several agreements were arrived at in connection with their payment and we have been receiving them in one form or the other.

(7) During war period dollar became hard currency. As a result thereof British empire countries pooled their dollar resources into Empire Dollar Pool. Later on it was designated as sterling-area Dollar Pool. Dollars were given to each country after taking into consideration her requirements. Since 1947, we are free to spend our dollar earnings in any way we like.

TEST QUESTIONS

1. Write a note on the causes effects and removal of post-war inflation.

2. What led to the devaluation of rupee? Discuss its effects.

3. What are sterling balances? How did they accumulate? Why did Britain not want to pay them?

4. What effects did sterling accumulations have on India's economic position? Discuss the effects of agreements in connection with their repayment.

5. What do you understand by Sterling Area Dollar Pool?

CHAPTER XII

Present Situation

The present Indian currency system is based on International Monetary Fund sytem. This was evolved in Bretton Woods Conference. This is in vogue in India since 1947.

1. Description of Present Currency System and its Merits and Demerits

According the present system, India has got an internal currency which is convertible in foreign currencies with some control on the basis of a fixed exchange rate with gold. Of course, the value of this internal currency is fixed in terms of gold, but it is not exchangeable with it. All the member countries of I. M F. have got the value of their respective currencies fixed in gold, but none of them is exchangeable with it. The only advantage of this declaration of gold value of each currency is that its exchange value with other currencies is fixed. They, however, are convertible with some restrictions for the present. In fact, we have to look to our resources of international funds before we can allow exchanges.

If our resources of a currency fall short we cannot allow its unlimited sale and if it is otherwise we cannot allow its unlimited purchase. Hence, exchange control is necessary.

Our internal currency consists of both metallic and paper money. Metallic currency includes rupee coins and small coins. Of the latter, eight anna, four anna, two anna, one anna, half anna pice, half pice and pie coins are to continue only up to March 1960. Ten naya paisa, five naya paisa, two naya paisa and one naya paisa coins which were introduced on April 1, 1957 will, however, continue to circulate. 100 naya-paisas make a rupee. Fifty naya paisa, and twenty-five naya paisa coins will be minted shortly. Paper currency includes notes of rupee one, rupees two, five, ten, one hundred, one thousand and ten thousand.

Metallic currency can be minted according to the Currency Act of 17 February 1947, of any metal. Hence, rupee, eight anna and four anna coins were made of nickel and two anna, one anna and half anna coins of nickel and brass alloy. Nickel and brass alloy consists of 79% copper, 20% zinc and 10% nickel. Pice, half pice and pie coins were made of bronze. Rupee coin weighs 180 grains, eight anna 90, and four anna 45. Two anna coin weighs 90 grains, one anna 60, half anna 45 and pice 30 grains. Half pice and Pie coins have not been coined for long, their weight being respectively 37½ grains and 25 grains. Ten naya paisa, five naya paisa and two naya paisa coins are also cupro nickel, their weight being 5 grams=77.16 grains, 4 grams=61.62 grains and 8 grams=46.29 grains respectively. One naya paisa is a bronze coin of 1.5 grams =23.15 grains. New rupee coin, fifty naya paisa coin and twenty-five naya paisa coins will also be nickel coins of 10 grams, 5 grams and 2.5 grams respectively. All these are issued by the government through the Reserve Bank of India on requisition. Similar is the case with one rupee note.

Notes of the denomination of rupees two and above are issued only by the Reserve Bank of India which has its monopoly. The Bank has got its separate Department for this business known as the Issue Department. The composition of its Assets and Liabilities have already been discussed in a previous chapter.

The notes issued by the Reserve Bank of India and currency issued by the Government are interconvertible. The statutory value of Indian rupee is 0.186621 grams of gold. Reserve Bank of India exchanges foreign and Indian currencies at this rate with some restrictions.* Ordinarily this business is transacted by authorised banks, but they can do it with the Reserve Bank beyond a certain limit.

Merits. (1) Our system is based on an international system. The currency system of most of the countries is like this.

(2) The form of our internal currency is quite convenient. We have both metallic and paper currency in circulation. Our metallic currency is not uneconomical.

(3) Note-issue is done by a central bank. It is elastic.

Demerits. (1) The system is artificial. Hence, it does not command general confidence As a result people have the tendency to invest their savings in land, house property, gold and silver. The consequence is that industries and trade do not get sufficient capital.

(2) The value of currency has been falling. This is also why people have lost confidence in it.

(3) Our currency is token. We cannot realise its full value from the issuer. Its gold value is only a myth. We cannot get it.

(4) Most of our foreign assets against notes consist of sterling which is not held in so much esteem as dollar. We cannot purchase goods to our liking in foreign countries.

2. Rupee Exchange Rate

As we have seen previously, the value of rupee was lowered in 1949 in terms of dollar and gold. Since then, this question has always been held in dispute. At times, the question of the revaluation of rupee is raised afresh. The following arguments are generally advanced in this connection :—

(1) Devaluation has made imports from countries outside sterling area or from countries in terms of whose currencies this was done, dearer. Revaluation will make them cheaper.

(2) Revaluation would allow us to get increased currencies of the above countries as a result of our exports to them. We would also get more of Pakistan rupees on this account.

(3) Price-level would drop in the country as well.

But this would not be so. Foreigners would not allow us to be benefited. They would increase the cost of their exports to India. Similarly they may not import from us to the same extent The present tendency of the prices as well do not warrant revaluation of rupee.

Besides, there are several important points against revaluation :—

(1) It does not befit us under the present instable condition in the world to revaluate our currency whenever we so decide. Fillip to exports can be given in several other ways.

(2) When rupee was devalued, it was said that this was being done as most of our trade is with sterling area countries. Since then the position has not changed.

Our Finance Minister, Shri Chintaman Deshmukh, said then, "We have at present decided not to revalue our currency and this decision has been taken solely in our interest. Hence, so long as circumstances do not change we must stick to our decision Whenever we feel necessity, we shall change our decision"

3. International Co-operation

India is a member country of both I M. F. and Bank. A section in the country was opposed to this. It was said that no arrangement had been made in the provisions of the I. M. F. to solve the problem of our sterling balances. Besides, our quota in the I. M F. and the Bank was not in accordance with our importance. Hence, difficulty would arise in securing sufficient credits from them to meet our requirements and for the development of the country. India was also not assigned a permanent place in the Executives. But at last, we decided to become member, and as Russia decided otherwise we naturally got a permanent seat in both these institutions.

The following advantages have accrued to us as a result of our membership in these institutions :—

I. M. F. (1) India has been obtaining foreign currencies from it to the extent necessary to meet her day-to-day needs. It gave her dollars several times when we needed them.

(2) Gold value of rupee having been declared, it is now independent of sterling.

(3) India is a permanent member of its Executive. Hence, she takes part in moulding its policy. This has increased the country's prestige.

(4) Rupee has been made convertible into the currencies of its member countries. This has facilitated India's foreign trade.

(5) We get the benefit of its expert advice whenever we require it.

4. Decimalisation of Coinage

As we have already seen since April 1957, decimal coins have been in use It has brought over a change in our currency system which was formerly based on quarto system. Decimal system of coinage, weights and measures are certainly advantageous. Most of the countries of the world have them. We have made a beginning, and we shall soon have all coins, weights and measures on decimal system.

SUMMARY

1. Present system of Indian currency is based on I. M F. system. Under this the gold value of internal currency is fixed, they are not to be mutually exchanged The gold value of almost every currency is fixed Hence, their mutual value can be easily determined. India's internal currency and other foreign currencies are inter-exchangeable through the Reserve Bank of India. Internal currency consists of both metal and paper Notes of the denominations of more than a rupee are issued by the Reserve Bank of India. As against this it maintains a reserve whose constitution is according to law. Reserve bank notes are convertible into rupee coins and notes issued by the Government Indian currency is token and its full value is never realised This is its main defect Its merits are that it is akin to the system followed almost all over the world, it is convenient to handle and finally notes are issued by a

bank. Its demerits are that it is artificial which fact fails to inspire confidence of the people in its value. Further, it has been losing in its purchasing power and also that the rote currency is backed largely by sterling which is not freely convertible in hard currencies.

2. The arguments advanced in favour of the revaluation of rupee are—(1) imports from countries which did not devaluate have become dearer; revaluation would render them cheaper. (2) exports to them will fetch more of their currencies, and (3) Price-level would fall. But all this is not certain. As against this revaluation does not befit us. The reasons for which rupee was devalued are still there. Hence, this can be left to future, according as the conditions warrant.

(3) India has benefited by the membership of both the I. M. F. and the Bank. She has been getting hard currencies from the former, rupee is not dependent on sterling, we have our permanent representation on its executive, rupee is interconvertible with foreign currencies and its expert opinion is always available to us.

(4) Since April, 1957 we have decimal system of coinage in this country. The same system of weight and measure is also under introduction.

QUESTIONS

1. Describe the present monetary standard of India pointing out its merits and demerits.

2. Give a short account of the various legal tender money circulating in this country. How is it that their face value is maintained higher than that of their intrinsic value ?

3. In what way does the present monetary standard in India work ? Do you wish to bring any change in it ?

4. Give your arguments for and against the revaluation of rupee.

5. What advantage does India derive from the membership of I. M. F. ?

6. What do you understand by decimalisation of coinage ? What steps have recently been taken in this respect ?

7. What are the essentials of a good currency system ? How far does the Indian currency system satisfy the requirements of a good currency system ? (B Com Part I—195., 1955, 1957 Agra).

8 What are the essentials of a good monetary system ? How far does the present currency system of India satisfy those conditions ? (B. A. &B. Sc.—1942 Agra).

9. What system of currency exists in India at the present time ? How does the Government of India maintain the exchange value of rupee ? (B. A. & B. Sc. 1943 Agra).

APPENDIX A

ENGLISH CURRENCY SYSTEM

(*A Historical Development*)

English standard was originally a silver standard. During Anglo-Saxon age pound weight (lb) was equal to 4 ounces, and money value assigned to a pound of silver was a money pound (£). Of course, no pound coin was coined probably because its weight would have been ridiculous and because money value of commodities being low there was no need of a coin of a high value. Shillings were coined, and they being one-twentieth part of a £ contained one-twentieth of an Anglo-Saxon pound (lb) of silver, *i e*, 4 oz. ÷ 20 or $\frac{1}{5}$ ounces in weight. These came to be gradually supplemented with other silver and bronze coins as well. In 1163, a number of gold coins were also coined with a view to circulate at 20s. But silver coins being much worn out, they were exchanged according to weight—sometimes as many as 30s. being available for one gold coin. 'Guinea, as the gold coin was called, perhaps because gold came from Guinea Coast, was equal to 30s in clipped and counterfeit coins and not in good money. There was brought about subsequently a recoinage of silver and the price of guineas fell to 22s. But the new silver rapidly disappeared and gold poured into the country.

'Gresham's law was in operation in its second form. Gold was over-rated, and therefore was driving silver from circulation.' Of course no legal ratio had been fixed but the Treasury Board had issued instructions to the tellers in the receipt of Exchequer to receive guineas at 22s. each pursuant to the advertisement in the Gazette.

Sir Issac Newton was asked to give his advice, and he issued a report in 1717, wherein it was shown that in France, Holland, Italy, Germany, Poland, Denmark and Sweden, the ratio between gold and silver did not exceed 15 to 1, and that at this ratio the guinea would be worth 20s. 8½d. in silver. But in England, the guinea at this time passed at 21s. 6d., and it was, therefore, a profitable business to send gold to England and buy silver with it for export to these countries. Hence, he thought that the taking off about 10d. or 12d. from the guinea would serve the purpose, though his recommendation in the first instance was for a reduction of only 6d. and find out by experience what further reduction would be most convenient for the public. As a result, a Royal proclamation rated the guinea at 21s. This should have been the first step only according to Newton, but no further steps were taken although this reduction was quite inadequate as events soon proved.

Thenceforth, gold and silver were by custom, in the absence of any legislation on the subject, legal tender to any amount. The mint was also open to the free coinage of both, and they circulated at a fixed ratio to each other as well. This means that there was a perfect bimetallism. But no one tendered silver to the mint to be coined because it was worth more as bullion than as money. The result was that the amount of silver coins in circulation went on decreasing and what was left was much worn out. In 1774, they were declared for this reason, to be legal tender for sums exceeding £ 25, only by weight and not by tale at 5s. 2d. an ounce.

Slowly though steadily they relegated to a subsidiary position, and by an Act of 1816 were made legal tender only to the extent of 40s. Their metallic contents were also reduced. From 1817, 1 ounce of silver was contained in 5½ shillings instead of in 5 shillings. So far the standard unit of account in England did not coincide with the standard unit of the coinage. Sums had been reckoned in pounds, shillings and pence; but pounds had never been coined—a shilling was only one-twentieth part of a pound and gold coin, *viz.*, the guinea at first circulated at varying rates and then from 1717 onward at 21s. Hence, payments were made in guineas. This double system was very troublesome; and by the Act of 1816 gold sovereigns of a lower weight and rated at 20s. came to be minted. This brought the unit of coinage into conformity with the unit of account.

As a result of the War of 1914-18, there were brought about two very important changes. Firstly, gold coins went out of circulation and secondly the alloy in the silver coins was increased to 50 per cent.

At present, British currency consists of notes issued by the Bank of England and silver and bronze coins of various denominations silver coins being legal tender up to 40s. and bronze coins up to 1s.

APPENDIX B

HISTORY OF THE GOLD STANDARD RESERVE

The gold standard reserve was established in 1900. The Fowler Committee had recommended that the profits on the coinage of rupees should be set apart and kept in gold as a special reserve in India. The principal use of the gold reserve as laid down by them was to make it available for foreign payment whenever the exchange fell below specie point.

Functions. But as soon as the reserve was established, the profits on coinage were remitted to London and invested in securities, and since then although the original purpose remained the same, the method of performing its function changed. In case, there was an unfavourable balance of trade in the country and exchange tended to fall below the specie point, the Secretary of State stopped issuing council bills and thus checked an addition to Indian currency. This had the desired effect of raising the value of rupee by restricting its supply. At such times, if the Secretary of State needed funds in London, he could fall back upon the reserve. The Government of India also sold reverse councils in India on London. The effect of doing this was that the internal currency being withdrawn from circulation its value in terms of sterling tended to rise. Thus, besides strengthening the exchange rate, it also liquidated the unfavourable balance of trade, as importers of commodities purchased reverse councils and sent them to their creditors in London who got payment in gold from the gold standard reserve on their presentation to the Secretary of State. Thus it served three purposes, *viz.*, (1) strengthening of the exchange rate, (2) liquidation of the unfavourable balance of trade, and (3) meeting of home charges.

Position. It has been observed that the Fowler Committee had recommended the reserve to be kept in gold in India, but this was not done. Instead, it was transferred to London and invested in securities. In 1906 came another change.

The difficulty in meeting the demands for rupees led to the formation in India of a special reserve for the purpose, out of gold standard reserve. This was to be in coined rupees and was to form a part of the profits on the coinage of rupees. Thus two branches of the reserve were formed, (1) London branch, and (2) the Indian branch in the form of rupees.

In 1907 on the recommendation of a Committee known as the Mackay Committee, appointed by the Secretary of State to consider the question of Indian railway finance, a sum of more than a million pounds was transferred from the reserve to the provision of rolling stock and other improvements on Indian railways, It was also decided that in future one-half of any profits on the coinage of rupees would be transferred for this purpose until the gold standard reserve reached £ 20 million. It was apparently contemplated that after the total had been reached, all profit on the rupee coinage would be diverted from the reserve. But a serious crisis occurred in the year following, and decision had to be changed. The reserve was hard hit by this crisis. In all, more than £8½ million were withdrawn from the reserve to meet the reverse councils for strengthening the exchange value of the rupee. There was much public criticism on the location and composition of the reserve. The Chamberlain Commission appointed to give its opinion decided many of the points in this connection Firstly, it recommended that no limit was to be placed on the total reserve and the profits on the coinage of rupees were to be exclusively credited to it. In addition, it recommended that (1) a much larger portion of the reserve in which rupees were held be abolished, and (3) the most suitable place for the location of the reserve was London. These recommendations were accepted and given effect to with the only exception that during and after the war the reserve was held chiefly in securities. The recommendations of the Babington Smith Commission were also to the same effect as those of the Chamberlain Commission with the only exception that it considered the holding of a portion in gold in the reserve in India as necessary in order to inspire confidence in the public. In the years that followed the amount of the reserve mounted up to more than 40 million, at which figure it was kept till its unification with the paper currency reserve on the establishment of the Reserve Bank of India, as proposed by the Hilton Young Commission.

The Silver Redemption Reserve. It will not be out of place to mention here the establishment of the silver redemption reserve consequent upon the dissolution of the gold standard reserve on its unification with the paper currency reserve. Section 36 (1) of the Bank's Act requires Government to pay full legal tender value for surplus rupees returned by the Bank under the provisions of that section. To meet this obligation a silver redemption reserve amounting to Rs. 10 crores was constituted by the Government with effect from the 1st April, 1935, and held in gold and securities.

ERRATA

Pages	Lines	
1		foot note read 'coins' for coies'.
2	12	read 'billon' for 'bullion'.
3	17	delete 'of gold' after 'love'.
9	6	read 'instructive' and not 'constructive'.
9	36	read 'fineness' and not 'finesness'.
12	12	delete 'and' before 'has suspended'.
13	last	read 'Bland Allison' for 'A land Blison'.
17	1	read 'difficulties of'.
18	2	read 'far' for 'for'.
19	33	read 'effect on'.
19	last	read 'uncertainty' for 'incertainty'.
20	1	read 'diminution' for 'diminuation'.
20	25	read 'form' for 'from'.
21	18	read 'pass' for 'past'.
21	29	read 'is' for 'in'.
23	8	read 'proposed'.
24	8	add 'year' after 'same'.
27	17	read 'he' for 'be'.
27	30	read 'far' for 'for'.
28	6	read 'to be felt'.
28	20	read 'far' for 'for'.
28	27	read 'had' for 'and'.
29	15	read 'four-fifths'.
32	3	read 'connection'.
32	6	add 'defects' after 'inherent'.
32	19	read 'advanced' for 'admitted'.
32		Question 2 deleted second 'said'.
32	last	read 'gold' not 'sold'.
37	35 & 36	delete 'of less'.
39	6	read 'reverse' for 'reserve'.
39	14	read 'the exchange strengthened'.
39	20	read 'reverse' for 'reserve'.
46	20	read 'reverse' for 'reserve'.
57	last	read 'India's' for 'Indian's'.
60	25	read 'Dalal' for 'Dulal'.
60	last	but 3rd full stop before 'Gold'.

Pages	Lines	
60		Question 4 read 'first' for 'last'.
65	last	but 5th delete 'a' before.
74	1	read 'same' for 'srme'.
74	13	last word is 'which'.
79	21	read 8·47512 for ·847512.
80	20	add 'export bills and' in the last.
80	22	read 'sterling' for 'sterliag'.
81	22	read 'coins' for 'coint'
81	23	add 'and' after 'Central Bank'.
86	21	read 7·53342 for 3 53344.
93	last	but 3rd add 'U. S. A.' before 'went' and delete 'metallic' after 'step'
95	20	read 'unemployment' for 'employment'.
109		foot-note read 'lieu' for 'lien'.
110		foot-rote read 'one' for 'ane'.
112	4	read 'Reforms'.
113	35	read for' for 'or'.
114	1	read 'to' after 'notes'.
114	21	read 'improvements'.
115	15	read 'subjected' for 'objected.
122	8	last word is 'after'.
122	30	read 'acdute' for 'acute'.
122	13	read 'finally' for 'finaly'.
122	last	but 5th read 3½% for 3½%.
125	9	read 'surrender' for 'surender'.
126	last	but 6th line read 'every' for 'very'.
127	4	read 'continued' for 'continud'.
128	33	read 'companies' for 'companses'.
132	29	read 'reduction' for 'ruduction'.
133	35	read 'unwarranted' for 'an warranted'.
135	6	read 'expansion' for 'expantion'.
135	14	read 'deficits' for 'defecites'.