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# THE FUTURE OF THE RUPEE

BY

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## P R E F A C E

The object of this small book is to draw attention to the various problems which will arise after the war in regard to the determination of the future value of the rupee both internally and externally. In recent discussions on the future value of the rupee, attempts have been made to think either in terms of a higher or a lower rupee, that is, a rupee whose exchange value may be more than 1s. 6d. or less than 1s. 6d. In such discussions several fundamental points have been ignored. The same is true of the attitude which assumes that the rupee should be kept at 1s. 6d. and that no change is called for. It is proper that this important problem should be fully discussed by all those who are in a position to throw light on the same from different points of view, so that an intelligent understanding of its complexity may be reached, and efforts at a timely and correct solution organised. We place this small volume before the public in the hope that it will help in some measure towards this objective.

Our thanks are due to the editor, *The Commerce*, for permission to make use of our article on "The exchange rate of the rupee after the war" and to Dr. D. T. Lakdawala, Lecturer in Economics in this School, for help in the preparation of this work as well as for seeing it through the press.

*School of Economics & Sociology,*  
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23—12—1944.

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## I. THE SEARCH FOR STABLE MONEY

### 1. *Stable Money*

One of the essential characteristics of sound money is that it should be comparatively stable. The monetary history of the world, we find, is a record of efforts to devise ways and means of evolving a system in which comparatively stable money can exist. This importance of the stability of money is due to the fact that changes in the value of money bring about great disturbances in the relations of different sections of the people of a country and affect its economic life adversely. In modern times we use money as a unit of account for various transactions not only in the present but also for the future. When we do so, we do so on the assumption that the unit of money in terms of which the transactions are made will be stable over the period of time for which they are made. Long period contracts, insurance policies, provident funds, savings in other forms and the relations between creditors and debtors will, for example, have an entirely different meaning if the unit of account, in terms of which these are made, changes. When we assume similar stability of the unit of measurement, say, the yard-stick in connection with measuring cloth, for example, we are on comparatively safe ground. This is so because the yard-stick does not change and if some one tries to manipulate it, he will be easily found out and even punished. In the case of money, however, this assumption of stability which all of us make, though unconsciously, in connection with most transactions, is not always true because the value of money is liable to change. This change in the value of money is reflected in the phenomena of rising and falling prices. When the value of money rises, the prices of commodities tend to fall ; when the value of money falls, the prices of commodities tend to rise. Such changes affect different classes of people differently ; some reap temporary advantages, others suffer temporary disadvantages. If the fluctuations are wide and prolonged, the disturbances may bring about serious dislocation in the economic structure of society. It is in order to prevent such difficulties that the aim of monetary theory and practice has been to evolve stable money.

## 2. *Internal Stability vs. External Stability*

The primary need of a community is thus stability of money, i.e. a stable price level. For a closed economy, this would be the criterion of soundness. Modern countries have, however, trade relations with other countries, and in the case of some, external trade is relatively more important than internal trade. If each country had an internally stable currency, and if there were no dynamic changes such as due to changes in population, tastes, capital accumulation and technique, the foreign exchange market would soon establish ratios of exchange between the various national currencies that would express their relative purchasing power in terms of goods and be also stable with respect to one another. This combination of internal and external stability of money can, however, be realised only under the hypothetical—and unrealistic—conditions mentioned above. ✓ In actual practice, since economic changes take place at different rates in different countries, the problem arises of choosing between the stability of the value of money with reference to internal prices or its stability in terms of other currencies, i.e. the stability of the exchange rate. It is difficult to say *a priori* which of the two criteria is to be preferred. We have mentioned above how a changing price level creates injustice among different sections of the community. Unstable exchange rates are also harmful inasmuch as they upset the calculations of exporters and importers. ✓ A high external value of the currency unit tends temporarily to stimulate imports and slow down exports; a low exchange rate has the opposite effects. The exchange rate has also a bearing on movements of liquid funds from one country to another, and these movements, if not checked in time, may cause serious repercussions on the entire economy of the country in question. Moreover, under certain conditions, an adverse movement of the price level caused by an unduly high exchange rate may even put into operation cumulative factors which may end up in a general slump. For all these reasons, most countries desire some stability of the external value of the currency unit. Since the last war, most countries have had to face this dilemma: which to choose, stability of internal prices or of the exchange rate? The former is necessary for ordered progress within the country, but the latter is also important, especially, as we have said above, for countries whose economy is based on extensive foreign trade and

foreign lending and borrowing. The world is groping for a currency-and-exchange system which can preserve—to whatever extent possible—the best of both the worlds i.e. as much of exchange stability as is compatible with the needs of the domestic economy as determined by the national policies envisaged.

### 3. *The Old Gold Standard*

For many years before 1914 it was believed that the world had achieved comparatively stable money under the system of the gold standard. Gold was considered to be comparatively the most stable of all commodities and was therefore used as a standard of value. The principal countries of the world fixed their currency units in terms of gold and tried to maintain their value at the fixed level. This was done by maintaining the convertibility of the currency unit into gold and *vice versa* on demand by the public. For example, in England though gold coins did not circulate, in practice, the Bank of England was willing to convert pound notes into gold at the fixed value of 113 grains per £ sterling and was also willing to issue notes at the same rate in return for gold. This practice along with the free movement of gold between countries, brought about comparatively fixed exchange parities between the leading countries of the world which were on the gold standard. As the gold value of each currency unit was known and fixed, its exchange relation with any other currency unit could be easily traced so long as both were related to gold and were convertible into gold at fixed rates. Such fixity of exchange relations between countries enabled international trade to be carried on smoothly because bankers and merchants could make their calculations without much difficulty. But this introduced, as one would expect, a somewhat unstable element in the internal price level of each country. The general price level throughout the world in terms of gold tended to be equalised because of the operation of the gold standard which involved a free movement of gold and convertibility of currencies into gold at fixed rates. Through this mechanism disturbances in the economic position of any one important country were reflected in others before equilibrium was restored. If, for example, England exported more at any given time than she imported, she would be paid by the foreign countries in gold for her excess of exports. The incoming gold would

be tendered to the Bank of England and notes demanded with the help of which the export traders would be paid. The expansion of currency thus brought about would have the effect of raising the internal price level in England thus making British goods more costly to the foreign buyer. There would, in consequence, be an automatic adjustment inasmuch as the foreigners would now reduce their demand for British goods. The opposite would be true in case a country had an excess of imports at any given time and had to pay the foreigner in gold. The gold would be obtained by tendering currency to the Central Bank which would result in a contraction of currency and therefore bring about a general fall in the price level. As in the other case, this would be followed by an automatic adjustment inasmuch as the cheaper price of goods of such a country would stimulate demand for them from foreigners in due course. In the above illustrations we have assumed that the adjustment would take place in the country from which the movement of trade originated. In practice, however, international trade is more complex and it may happen that a higher or lower price level in one leading country is reflected to some extent in other countries through the mechanism of the gold standard which tends to bring about the same general level of prices throughout for internationally traded goods. The conclusion is that though exchanges remain fixed under the gold standard, the internal price levels do move in either direction and are not stable. In fact, stable exchange rates can be maintained only by allowing internal price levels to vary suitably. So long as such movements were of a minor character, no serious difficulty was experienced, but if such movements assumed greater proportions, they were bound to cause serious difficulties.

#### 4. *Post-war Developments in Exchanges*

The inherent instability of gold was perceived during and after the last war. Most of the leading countries abandoned the gold standard during the war but were anxious to return to it as soon as possible. The U.S.A. maintained the gold standard to find that the value of gold had depreciated in terms of commodities by about one-half. The consequent depreciation of the dollar meant a higher price level in the U.S.A. upto 1920. The price levels in most other countries however were higher still on account of inflation which had been

practised during the war. A return to the gold standard by these countries meant a lowering of their price levels in harmony with that of the U.S.A. if they wanted to fix the value of the currency unit at the pre-war parity. In the alternative, those countries which could not do so preferred to keep a higher price level by changing the gold parity of their currency and by fixing it at a lower level suitable to the new higher price level. Countries like England which adopted the former method in restoring the gold standard in 1925 had to undergo the difficulties of deflation and falling prices. Most countries however found it extremely difficult to maintain the gold standard because of the mal-distribution of gold resources. Most of the gold stocks of the world had been drained to America and the leading countries did not have sufficient stocks of gold for monetary purposes to maintain the convertibility of their currency into gold. The experiment to restore the gold standard in England and other countries after 1925 failed because of this and other reasons ; the gold standard was abandoned by England in 1931 followed by other countries. The U.S.A. devalued the dollar by about 40% in 1933 but maintained the *de facto* convertibility of the dollar into gold.

##### 5. *The Tripartite Agreement and Currency Blocs*

From the above survey it is obvious that during the last war and after we could neither have fixed exchanges nor stable price levels. The weakness of the gold standard was fully revealed and opinion grew in favour of a different system. The U.K., the U.S.A. and France gradually drifted into what is called the Tripartite Agreement the object of which was to maintain comparatively stable exchanges between their currencies. They instituted what are called Exchange Equalisation Funds with the help of which the Governments of these countries entered the exchange market to iron out any big fluctuations in their exchanges. While doing so they developed their central banking machinery with the help of which they tried to bring about a comparatively stable price level within their own territories. At the same time the world was divided into currency blocs : we had the Sterling Bloc comprising countries which had their currencies linked to sterling, and there was the gold bloc represented by countries which tried to maintain the gold value of their currencies. International trade was naturally diverted more to these blocs.

ing into existence new economic relations, causing friction in some cases. Before this new technique of managed money could be fully developed, the present war broke out in 1939. The problem of evolving a stable monetary system for each country and for the world as a whole therefore remains as exciting and interesting as ever and the efforts of the International Monetary Conference recently held in the U.S.A. are partly in this direction.

## II. THE RUPEE AND THE WAR

The history of Indian currency reveals how the efforts to achieve stable money in this country have not succeeded in bringing about a stable rupee. We started with the intention of developing the gold standard, but due to a combination of circumstances, we came to develop the gold exchange standard. And, this, too, was in effect a sterling exchange standard. The emphasis of this system was on the stability of the exchange value of the rupee in terms of the sterling irrespective of its effect on the internal price level.

### 1. *The Gold Exchange Standard*

In order to appreciate the significance of the above policy in its proper perspective, we shall review in brief the principal landmarks in the history of the rupee under British rule. The monetary system in India was put on an organised basis in 1835 with the rupee as a full value coin consisting of 165 grains of silver plus 15 grains of alloy or a total weight of 180 grains. The mints were open to the free coinage of silver on public demand. India was thus on the silver standard from 1835. The exchange value of the rupee was fixed at 2 shillings gold or Rs. 10 to a pound sovereign. This was roughly in approximation to the current values of gold and silver at the time. The fall in the gold value of silver which occurred after 1871 introduced difficulties. The value of the silver rupee began gradually to fall, introducing uncertainties in public finance as well as in trade and therefore in the economic life of the country. With the fall of a penny in the value of the rupee, the Government of India was at one time required to find an additional crore of rupees to finance the sterling payments in England. Traders and bankers, on the other hand, were involved in considerable uncertainty so far as their transactions were concerned which

were naturally upset by the continuous fall of the rupee. The first step was not taken till as late as 1893 when the mints were closed to the free coinage of silver. The value of the rupee had fallen to 13d. by that time. The relative scarcity of the rupee currency thus brought about led to a gradual increase in its value and by 1898 it reached 1s. 4d. It was in that year that the gold exchange standard was introduced. This meant that the Government of India was willing to accept gold and issue rupees in exchange at the rate of 1s. 4d. though they were not willing to give gold in return for rupees. They instituted arrangements to give sterling in London for rupees tendered in India at the same rate. This had the effect of maintaining the rupee at 1s. 4d. sterling, and so long as sterling was on gold, India could be told that in effect she was on the gold exchange standard. The India Office used to sell Council Bills in London to obtain sterling for its own requirements. Those merchants who had to pay to India in return for Indian goods were willing to buy such Council Bills and pay sterling for them, the equivalent of the sterling in rupees being payable to their nominees in India by the Government of India. The sales of Council Bills were determined not merely with reference to the requirements of the India Office but also with reference to the trade situation and the possibilities of obtaining funds with comparative ease. The rupees issued by the Government of India in consequence were often in excess of their liabilities to pay on account of sterling charges. This meant that the supply of additional currency in India was determined more by external factors than the internal requirements of the people of the country. The changes in the price level were ignored, the sole concern of the Government being to maintain the exchange value of the rupee at 1s. 4d. The difficulties which the gold standard introduced in the internal life of other countries were reflected in this manner through our relation with the sterling in the manner explained above.

## 2. *The Silver Standard*

During the last world war the price of silver rose to such heights that it became profitable for people to melt the silver rupee and to sell it as bullion. The gold value of 165 grains of silver was now higher than 1s. 4d. This contingency was not foreseen when the gold exchange standard was introduced in 1898. The situation was

met by raising the exchange value of the rupee in accordance with the rise in the price of silver. The rupee accordingly rose from 1s. 4d. gradually to more than 2 shillings. India was thus for all practical purposes on the silver standard during the period. The internal price level however rose fairly high. Because of the unusual war demand both on Government account and on trade account our foreign trade was not disturbed as in the present war. The requirements of currency were met by expanding the note issue, by introducing notes of smaller denominations and by obtaining silver from the U.S.A. for rupee coins.

### 3. *Towards a High Parity*

Though the pound sterling had depreciated in terms of gold, and the gold standard was not yet re-established in England and the currencies of the world were in the most chaotic stage, it was thought desirable by the authorities in this country to introduce a big change in the currency of this country soon after the last war. The advantages of a higher rupee sterling exchange had been perceived during the war so far as British imports into this country were concerned. Their desire to perpetuate this advantage blinded them to the other factors, both as regards certain world forces as well as the internal requirements of the country. The rupee was fixed by law at two shillings gold in 1920. As sterling was still below gold, two shillings gold, or 113 grains of gold, meant more than two shillings sterling and the actual rate varied with reference to the changing value of sterling in terms of gold in the London market. The two shillings gold rate of the rupee thus fixed introduced the wildest of exchange speculation and consequent fluctuations in India. The rupee rose at one time to as high a level as 2s. 11d. sterling. The Government of India in their determination to force the legal rate on the country began selling what were called Reverse Council Bills. This meant that people could tender rupees in India at the fixed rate and obtain equivalent sterling in London from the currency reserves. In view of the prevailing market rates this was a profitable transaction for most parties and there was a mad rush to obtain that advantage. About 54 crores of rupees worth of sterling was spent away in this manner from the reserves before the Government of India could realise that the effort could not succeed. When it was abandoned some time late in 1920, the rupee

went down to about 1s. 3d. This ruinous policy showed the extent to which the exchange value of the rupee was considered more important than its internal value, and the extent to which the authorities might go in bringing about a particular result without caring for the serious disturbances which such a policy would cause to the internal economic life of the country.

#### 4. *The Sterling Exchange Standard*

The rupee was left to itself thereafter for some time and no additions to currency were made. The story of the period of 1893 to 1898 was repeated and the relative scarcity of the currency gradually raised the value of the rupee. No action was taken when the rupee touched 1s. 4d., the pre-war rate. The obvious intention of the authorities was to allow the rupee to rise as high as possible so that a higher rupee-sterling exchange could be fixed in spite of the disastrous experiment of 1920. Strong protests were made from this country against this policy and the Finance Member of the Government of India cried halt when the rupee touched 1s. 6d. in 1926. Efforts were then made to stabilise the rupee at 1s. 6d. By this time the gold standard had been established in England at its old parity and the confusion due to changes in the value of sterling with reference to gold had disappeared. A Royal Commission was appointed to review and bless the policy developed in this way. Though the Commission recommended the introduction of the gold bullion standard in this country, we again got in effect a sterling exchange standard. The *de facto* rate of the rupee then in existence viz., 1s. 6d. was put on the Statute Book as approved by the Commission. The famous controversy between the 1s. 4d. and the 1s. 6d. rate which raged at that time was really a dispute for a correct level of prices within the country from all points of view. It was assumed however that prices had adjusted themselves to the 1s. 6d. rate and that it was not proper to disturb them again by having a lower rate. The weakness of the system was revealed in 1931 when England gave up the gold standard. There was a short-lived effort by the Government of India to make the rupee independent of the sterling. But this was soon given up due to mandates from England and the rupee was linked to sterling at 1s. 6d. The possible effects of this depreciation of the rupee in terms of gold in the form of a higher level of prices within the country were however concealed

by another and more powerful world factor. The big depression which started in 1929 had by now overtaken this country and the fall in prices was continuous and heavy. The position of large classes of people, chiefly agriculturists, became precarious in the thirties of this century. Palliatives were introduced in some Provinces by measures calculated to relieve rural indebtedness. Any suggestion for a monetary measure to affect the price level in the upward direction was stoutly opposed by the authorities. If a mild dose of inflation was ever justifiable, it was so under the conditions of this country during these years of prolonged depression in rural areas mainly due to external factors. But the Government of India preferred to look on and hoped that conditions would adjust themselves.

#### 5. *The Role of the Reserve Bank*

It was at this time that the Reserve Bank of India was brought into existence in 1935. It was required by law to operate the sterling exchange standard at the rate of 1s. 6d. per rupee. Itself a Bankers' Bank and the Bank of the Government of India it has all the attributes of a Central Bank in form. But so far as the principal object of monetary policy in any country is concerned, viz. the maintenance of stable money within the country, the Reserve Bank Act does not enjoin this duty specifically on the new institution. So long as the Reserve Bank functions within the four corners of the Act, it may therefore overlook this most important function of a Central Bank, viz., maintenance of the stability of the unit of value in the country for which the leading Central Banks of the world like the Bank of England, and the Federal Reserve Bank of U.S.A. have strained all their might even during the present war with comparative success.

#### 6. *The War and Indian Currency*

The outbreak of the war in September 1939 found India quite unprepared. The earlier period of the war till the entry of Japan was characterised by efforts to mobilise the human and material resources of India to help the war effort mainly in the Middle East and Africa. The advent of Japan into the war by the end of 1941 completely changed the situation. With feverish

activity the country had to be organised as a base of operations on a tremendously vast scale and the arrangements that were on foot in the preceding years were speeded up and considerably enlarged. Without going into the technical details of military preparations, we shall confine our attention mainly to the financial aspects of the same.

At the outbreak of the War a Financial Settlement was made between India and the U.K. by means of which the war expenditure in India was to be divided between the two countries. The principle was that in addition to the peacetime expenditure on defence which India incurred, she should bear all additional expenditure due to higher prices and due to the requirements of her own defence. In practice, however, the detailed clauses of the settlement were liable to elastic interpretation leading to the imposition of a larger expenditure on India than was justified by her own defence needs. The expenditure in India, however, was met in the first instance by the Government of India in rupees ; it was subsequently allocated between the two Governments according to the settlement. In consequence, India was reimbursed from time to time by payments in sterling in England equivalent to the rupee expenditure incurred by her on behalf of the U.K. The rupee finance required for the purpose was so large that it was not possible for the Government of India to find it from its ordinary resources of taxation and loans. The Government of India adopted the method of showing in the budgets only India's share of the war expenditure for which they made provision by way of additional taxes and loans. The remaining expenditure which was supposed to be borne by the U.K. was not shown in the accounts till recently and had to be inferred from indirect sources. The principal method adopted to finance these requirements was to issue more currency. For some time the effects of such additional currency were not felt. It is possible that early additions to the currency in the beginning of the war may have gone to meet that demand for additional currency which was required to give a little impetus to the low level of prices which existed in the country due to the great depression. It may also have met the demand created by new activity for the production of war materials. The addition to the currency however was large in 1941-42 due to the new preparations to meet the Japanese invasion and the effect of this on the price level was more marked. The year 1942-43

was characterised by the largest addition to the currency amounting to more than 318 crores of rupees in a single year. It was only after public attention to this method of finance was drawn mainly by economists in the country that the evil of ever-rising prices on this account was realised. As late as March 1943 the Finance Member in his Budget Speech tried to explain away the phenomenon of inflation and to minimise either its existence or its effects. But the realities of the situation were too powerful for him to succeed in his effort to conceal the truth and he at last decided from May 1943 to assume the fact of inflation and to introduce a series of anti-inflationary measures to check the evil of rising prices. Various controls have come into existence thereafter and though they have not been all successful, their combined effect has been to put a brake on the speed with which the price level was rising. Combined with other measures they have, for the time, checked the upward trend, though they have not succeeded in bringing about a substantial reduction.

The difficulties which the people of the country experienced in the matter of food, clothing, and other articles of necessity which because of high prices have been beyond the reach of many people, who were therefore required to restrict consumption, must be attributed in the main to the inflationary policy of Government. It was mainly the business community and the large agricultural producers who could reap the advantage of higher prices whereas the mass of the people suffered as consumers. The tragic tale of the famine in Bengal and of general mal-nutrition in various parts of the country has all merely to be mentioned to draw attention to the havoc that has been caused by this policy. The sufferings of India in the loss of human life and in the immeasurable loss of vitality of those who have survived and particularly of the rising generation cannot be ascertained. In assessing the contribution of India to the war, unless this suffering is taken into account, it will be a gross injustice to the people of this country.

### 7. *The Sterling Balances*

We have referred to the payments in sterling made to us by the U.K. in London on account of her war expenditure in India, and to the rupee finance provided by the Government of India

to meet such British war expenditure in this country. There is a close relation between the two. Part of the sterling received in England was utilised to repatriate the sterling loans of India. Inasmuch as India has paid off her sterling debt in this way it is an advantage. The greater portion of the sterling received in the above manner however has been invested in sterling securities, mainly short-term loans, and these are transferred to the Issue Department of the Reserve Bank of India in London. It is against this cover that the additional currency referred to above to finance British war expenditure in this country has been issued. The sterling reserve thus created has assumed large dimensions and has become the subject of controversy as to the method by which it could be utilised in the future.

There have grown several fictions and fallacies round these sterling balances in recent years. The British people at one time patronisingly said that India was able to accumulate these riches because of the generosity of Britain in agreeing to pay for the defence of India. The same people now adopt the attitude that the size to which the sterling balances have grown was not foreseen when the financial settlement was made and that steps should be taken to artificially reduce the volume of the sterling balances and also to change the terms of the financial settlement in favour of Britain. Some people in India were led to believe in the beginning that the sterling balances represented substantial wealth, that as a reserve against the rupee currency they helped to make the rupee strong and that India would be in a position to obtain substantial advantages from these balances after the war and therefore if these balances were allowed to accumulate India was not at a disadvantage. The same people in India are now crying hoarse against the possibility of losing their hold on the sterling balances because of the way in which they are now proposed to be dealt with by interested parties in England. It was not realised that the existence of the sterling balances could not give any support to the rupee so far as its internal value was concerned. The fact that these balances are a currency reserve and may be used for the maintenance of the exchange value of the rupee at a level not necessarily in the interests of this country was also not fully appreciated by the business people in this country though pointed attention was drawn to it. The Indian delegation at the International Monetary Conference has

failed to find a solution to this problem. In the meanwhile, the present method of financing British war expenditure in this country continues as before with consequent additions to the sterling balances.

The questions that will have to be solved by the authorities in this country after the war may be stated thus :—

1. At what level should the internal value of the rupee be stabilised?
1. At what level should the external value of the rupee be stabilised ?
3. What should be done with the large volume of currency which has come into existence during the war ?
4. How should the sterling balances to the credit of India be dealt with ?

So far as the immediate post-war period is concerned, all schemes of reconstruction as well as the adjustment of the economic life of the country to normal peace-time conditions will be largely influenced by the way in which the above questions are dealt with.

### III. THE FUTURE OF THE RUPEE : IMMEDIATE POST-WAR PROBLEMS

Before attempting to discuss the future of the rupee, we shall try in a general way to take stock of those factors which have come into existence during the war and which are likely to develop before hostilities cease. It is in the background of such existing conditions when peace arrives that the currency policy of the country will have to be based.

#### 1. *The Price Level and the Currency Factor*

In the first place, the total amount of currency notes issued which has now exceeded Rs. 1000 crores may still grow further if the present financial policy is pursued. If the war in Europe is not likely to come to an end till some time in 1945 as announced by Mr. Churchill, we may take it that it will at least take a year or more thereafter to deal with the Japanese in the East. Activities in India in connection with the campaigns in the East will then have

to be accelerated ; they will be financed in rupees as now by the Government of India. If such finance is provided by inflationary methods as at present, the currency circulation by the end of the war may go even to Rs. 1500 crores.

As the increase in currency in India is made against sterling securities put into the Issue Department of the Reserve Bank of India in London out of the proceeds of sterling received from H.M.G.'s Government in return for rupee expenditure incurred for them in India, we may take it that the sterling balances which are now about Rs. 1000 crores will also increase in the same proportion and may reach Rs. 1500 crores. (1,623) Crores

The demand liabilities of scheduled banks in the country have grown during the war partly on account of the fact that certain classes of people have obtained large monetary resources which they are not able to make use of at present. The total demand liabilities which were Rs. 616 crores on 29th December 1944 will have a tendency to grow further before the war comes to an end. The currency expansion in the above manner will lead to this situation. We may hazard a guess and say that if the demand liabilities grow in the same proportion in which they have grown hitherto in relation to currency expansion, they will amount to about Rs. 1000 crores.

It is well known that certain classes of people have hoarded currency during the war. This may be due to a lack of confidence in banks or their desire to keep themselves in a liquid position or for other causes not easy to explain. One of the reasons usually alleged is that those who have made profits in the black market and have succeeded in concealing the same from the income-tax authorities have preferred to follow this practice. Whatever the truth, the fact remains that anything between 150 to 200 crores worth of currency notes are perhaps not in circulation. If this tendency also continues as hitherto, we may assume that this amount will also increase in a similar proportion by the end of the war and amount to about Rs. 300 crores.

The question is whether the internal price level in the country will continue to rise due to a combination of these forces. We have seen that during the year 1944 the price level has not risen in the same proportion as it did during 1943. This is mainly due to the

various measures of control introduced by the Government of India. It is obvious, however, that though the rate at which the increase in the price level may occur has been slowed down because of these controls, if currency goes on expanding at the rate that we have assumed, there is bound to be an upward push on the price level in spite of the control measures. It is well known that the controls in this country cannot be, in the nature of things, as successful as they have been elsewhere. At the same time, if the currency is expanded to finance the war, it remains in circulation except to the extent to which it is hoarded and therefore temporarily withdrawn from circulation. The assumption that the Government can mop up such excess purchasing power by means of taxes and loans and therefore reduce its effect on the price level is not convincing. The resources obtained by the Government by taxes go back into circulation immediately by way of continued disbursements both for war and other purposes. Taxes and loans are helpful only to the extent to which they prevent recourse to inflationary methods of finance. But once more currency has been issued to meet war requirements, its effects on the price level is likely to persist except to the extent to which the controls are effective. We may assume therefore that though the price level may not rise in the same proportion as in 1943, it is likely to rise to some extent which cannot be easily estimated.

## 2. *Factors Leading to a Lower Level of Prices*

On the termination of hostilities two important events likely to have an effect on the price level will take place. In the first place the need for financing British and allied war expenditure in this country will have come to an end. To some extent, however, for a short period, some financing of this nature may be necessary. It will take some time for British and American soldiers in this country to be transported back to their countries and during that period they will have to be financed as hitherto. But once they have left the shores of India, this factor will disappear.

So far as the de-mobilisation of Indian troops is concerned, here also it will be a matter of some time. Indian soldiers serving overseas will come back and those serving within the country will also be gradually disbanded. During the interval they will have

to be paid as usual. After they are demobilised, there will be expenditure on account of various benefits which they or their dependants have been promised because of war service.

The various war factories which the Government of India themselves own and conduct will have to stop working. It is obvious that they cannot be stopped all of a sudden and a gradual arrangement to close them down is likely. In some cases, the factories may be dismantled altogether. In other cases, they may be reconditioned for civilian production and handed over to private parties or taken over by Government departments for peace-time work. In any case, the expenditure in this connection will be considerably reduced.

The same applies to the numerous training institutions for the army, navy and air forces which have cropped up throughout the country. Though some of them may be retained, their strength cannot obviously be at the present level and expenditure on such establishments must go down. Some of the activities of Government departments, particularly of the Supply Department, will also shrink, though it is possible that their services will be required for a time for the disposal of surplus stocks in the hands of Government.

These points are enumerated in order to show that within a year of the termination of the war the expenditure of Government will be considerably reduced in the above manner. Whether they would undertake expenditure of another character about the same time is a different question to which we shall turn later.

So far as industry in private hands is concerned, there is bound to be an adverse effect on it on the termination of the war. Those industries large and small which are now producing for the Government for the supply of war requirements will find that no new orders are available though existing commitments may be allowed to be executed. Those industries which are able to re-adjust to peace-time requirements will be in a position to carry on if they are able to supply the needs of the people at a reasonable price. Those others however which are not able to adjust in this way will find themselves in an extremely difficult position. Apart from their capacity or otherwise to adjust in this manner, some of them will be faced with foreign competition. If the foreign goods of good quality are landed in India at a price lower than that at which the local industry is able to sell similar goods, our industrialists will

find themselves faced with this additional difficulty of foreign competition.

The immediate effect of all these forces taken together will be to depress the price level in this country. It is impossible to say to what extent and how long these forces will operate. It is of importance however to consider the factors that will operate in the opposite direction, if not immediately, at least after a time, factors which will have a tendency to offset the depression and keep prices at a higher level.

### 3. *Factors Leading to a Higher Level of Prices*

We shall now consider those factors which are likely to bring about a higher level of prices or at least to prevent a depression. It is obvious that the immediate psychological effect on the termination of hostilities will be towards a depression. Most of the people who will be affected in the manner explained above will be in a confused state of mind and will not find easy adjustment so far as the employment of productive capacity is concerned. The other factors working in the opposite direction will take time to come into operation. How long this depression will last it is not easy to determine. To some extent its period will be cut short by the strength of the opposite forces some of which will come into play naturally and others can be brought into play by Governmental action.

As soon as possible, after the war is over, there is bound to be a general desire on the part of the people to obtain more consumer goods. The civilian population have had to restrict their consumption during the war in various ways. Most of them will be impatient and may expect an early fulfilment of their suppressed wants. Those of them who can make their desires effective in terms of purchasing power will try to obtain from the market such consumer goods. This will mean that the monetary resources which are now lying idle in some cases will be active. For example, those who have hoarded currency notes will be tempted to convert these notes into goods if possible. The same will apply to bank balances because the holders of these balances will try to make use of these balances at least to some extent for obtaining consumers' goods. Those persons who have invested in Government securities, parti-

cularly in cash certificates, may also be induced to cash such paper if they feel the need for obtaining goods of one kind or another. As consumers' goods required by all such people cannot come into the market at short notice, it is possible that the above forces may tend to raise the prices of such goods unless they are effectively controlled. In any case, the existence of such a demand will lead to efforts on the part of producers to make plans for producing such goods as quickly as possible. There is also the likelihood of a building boom in the post-war period. A number of people have purchased land during the war and have been unable to build on account of non-availability of material and also because of controls. The temporary depression referred to above may thus be countered and offset, and the country may find itself in the midst of new economic activities. It is possible, however, to imagine the circumstances when such activities may become over-optimistic. Producers may try to rush into all sorts of ventures in the belief that the demand was likely to be permanent. If they overshoot the mark, they may bring into existence unsound concerns and thus sow the seeds of difficulties for the future.

#### 4. *The Requirements of Planning*

It is at this stage that economic planning can become effective, can arrange for the ordered development of the country and can prevent possible difficulties. It would be desirable to plan Government expenditure so as on the one hand to obviate any serious depression and on the other to prevent a disastrous inflation such as occurred in Germany in the post-war period. This proper timing of Government expenditure is all-important for the future of the country. We should have adequate facilities both for agricultural and industrial production in such a manner that the progress of the country can be assured. In case we are not ready with such plans or are not in a position to execute them at the right time, we shall be left to the unsystematic and un-coordinated attempts of producers to meet the new demand somehow, leading to inevitable difficulties in the future.

In this connection, the position of various Joint Stock Companies which are now being floated with a view to do active work after the war may be considered. The flotation of such companies

is at present regulated by Government in the interests of the war effort. Permission is granted to new companies to obtain capital from the market on the understanding that a substantial portion of the capital raised is invested in Government loans. After the war there will be a demand from all these companies to obtain from Government their funds with a view to start new factories and other establishments. The only way in which Government will be able to repay these funds will be by raising new loans from the public at that time. The same applies to the refund of part of the E.P.T. which is due to concerns now paying it as a compulsory loan. This means that the capacity of the Government to enable these companies to start work will be limited by the capacity of the money market to loan fresh funds to Government each year. This, in turn, will largely depend on the capacity of the people to save because it is the savings of the people which ultimately go through the money market to subscribe to such loans. At a time when most people are likely to spend more on consumers' goods the amount of savings cannot be very large. If this puts a limit to the new resources which Government can obtain each year by way of loans, the pace of starting the factories which are now on paper will be correspondingly slow. At the same time, this will have an indirect effect on new enterprise during the period. There are bound to be people who have not yet made up their minds about starting new ventures and who may feel that the opportunity for doing so may come later. Such new ventures, if organised later, will compete with the demand for capital against the effort of Government to raise loans to return the funds to the existing paper companies as explained above. In this tug-of-war the rate of interest offered by the new ventures may be raised as against the rate offered by Government. If the resources at the disposal of Government are limited, it will have to decide an order of priorities according to which the funds will be returned to the companies now floated. These priorities may also be decided with reference to the scheme of economic planning if one is made and accepted by that time. In any case, there is bound to be a great pressure on Government on behalf of those who have floated companies now to get their names included in the list of priorities irrespective of the fact whether their concerns really fit into a scheme of economic planning or not.

The above analysis leads us to the conclusion that efforts are bound to be made to mobilise the savings of the people for industrial use and for other productive purposes. But there is another important factor which will limit the speed with which such industrial activity can be organised in the country. We depend on foreign sources for capital goods, for plant and machinery for the purposes of starting modern industries or even for rehabilitating our existing industries some of which have suffered considerable wear and tear during the war. The extent to which we can obtain the necessary goods will depend mainly on the capacity of the U.K. and the U.S.A. to spare such goods after satisfying their own requirements and also after meeting the needs of devastated areas in Europe for reconstruction. It is difficult to estimate the amount of capital goods or the value of capital goods that we shall require and obtain both for existing and for new industries after the war. The right balance can be secured only by the Government in co-operation with industry. But we may assume that the demand will be fairly large and insistent in the sense that those concerned will be anxious to obtain such goods as soon as possible.

Another important factor in the acquisition of such capital goods is the method by which we shall finance their purchase. In case the existing sterling balances to our credit are available to finance the purchase of such goods, we shall not have to send an equivalent amount of exports at the time. If we assume, however, that the sterling balances will be available to us only in instalments spread over a number of years, then the amount of capital goods that we can obtain in lieu of this will be limited by the instalment of the year. If we need more either of capital goods or of other goods abroad, we shall of course have to pay for the same on current account by means of an equivalent value of exports from this country.

In order that we are able to develop an export trade by retaining our existing markets and capturing others, we should be in a position not only to ensure the quality of our export goods, but also to see that the prices at which we are able to sell them in the foreign markets are competitive. In other words, the prices of our goods should be sufficiently low in order that we may be able to obtain and retain such an advantage. If we are not able to do so,

we shall be faced with difficulties in obtaining the goods that we require from abroad. This means that we should maintain the general price level in the country at a reasonably low level for effective international trade. The same tendency may be brought about, whether we like it or not, if foreign goods are sent to this country and sold here cheaply at a rate lower than that at which our producers are able to do. Such a situation can be offset by import duties, protective tariffs or otherwise, but there is bound to be opposition if India tries to raise heavy tariff walls against the imports from the Allies.

We have seen above that the forces leading to a general increase in the productive activity of the country will tend to raise the price level and may in course of time offset the temporary post-war depression referred to above. But we have also seen the need for a reasonably low level of prices in the country to meet foreign competition in the interests of our exports and also to meet such competition in our own local market. It is obvious therefore that we cannot maintain the present high level of prices and shall be forced to adopt a lower level. To what extent we should do so will be influenced by the price level which England and America decide to have in their countries. These two leading countries have succeeded in preventing an undue rise in their prices during the war ; they are likely to continue their present control policies in the interests of their export trade after the war so that their price level may not rise further. The question is whether we shall have to reduce our price level in keeping with these two countries and if so, what will be the method and the effects of such a policy ?

#### IV. THE FUTURE OF THE RUPEE : EXTERNAL INFLUENCES

##### 1. *International Aspects of Currency Regulation*

This brings us to the wider problem of international economic relations and the part that India should play in the same. It is likely that efforts will be made to organise international economic relations by mutual consultation among different countries and by joint decision as far as possible in important matters which affect world economic tendencies. The most important clue to what is likely to happen is to be found in the decisions of the International

Monetary Conference which was held at Bretton Woods in America in July 1944. The main object of the Conference, viz., to devise means for the ordered development of international trade and thereby increase employment is laudable. The International Fund provides for a systematic settlement of the balance of payments between different countries on trade account thus eliminating abnormal movements of funds between different countries. In addition to the Fund, the allied institution of the World Bank is supposed to help countries in need of foreign capital to obtain the same under certain conditions. The currencies of the important countries will have to be fixed in terms of gold, each country deciding its initial parity with gold as soon as possible. The important difference between the orthodox gold standard and the new system that is now proposed is this : that under the old system the exchange values of currencies were fixed in terms of gold, and changes due to different factors were reflected in the internal fluctuations of the price level. The internal economy of each country had thus to adjust itself to these external forces. Profiting by this experience, the I.M.F. has provided that it should be possible for member countries to change their parities with gold within limits in consultation with the Fund. But it is well known that gold itself is on occasions liable to change in value to a substantial extent, thus causing considerable difficulties in maintaining exchange values fixed in terms of gold. It is therefore laid down by the I.M.F. that a uniform change in the values of currencies in terms of gold may also be permitted under certain circumstances. Whether the elasticity thus introduced will remove the rigidity of the orthodox gold standard and will enable countries to obtain the other advantages of such a system will have to be seen from actual experience. All member countries of the Fund are expected to work towards this goal as soon as possible after the war is over. They will have to fix the gold parity of their respective currencies and in doing so they will have to determine their internal price level. For some time the conditions might remain abnormal. Each country will maintain the existing controls, particularly exchange and trade controls, but it is expected that such controls will be relaxed as early as possible. The underlying idea of the Fund is to promote international trade by the removal of all restrictions in the way of such trade in the long run.

## 2. *The Problem of Currency Parities*

It is obvious, however, that the Bretton Woods Conference has shelved the problem for the transition period, during which each country will seek to manage its currency in the manner it thinks best in its own interest. The question of choosing the proper parity will, however, arise at the time each country joins the Fund, for thereafter the freedom to vary the exchange rate will be only limited. What the length of the transitional period will be and whether during this period, the different countries concerned will take effective steps to bring their own price and cost structures more or less in parity with those prevailing elsewhere, so as to achieve a *de facto* rate of exchange which can thereafter become the *de jure* rate, it is difficult to say just at present. It can be said, however, even at this stage that unless by the time it is decided to inaugurate the Fund, the various member<sup>1</sup> countries have managed to bring their cost and price structures into equilibrium by a progressive relaxation of exchange controls and other restrictive measures, the problem of choosing the proper parity is going to present serious difficulties, especially for a country whose currency policy is not entirely in its own hands. With the help of such controls supplemented by appropriate clearing arrangements, the balance of payments position can be safeguarded for any length of time. But, so long as such controls persist, it is difficult to estimate the relative purchasing powers of the different currencies, or to judge what external value of a given currency would secure an even balance of payments. From this point of view, it does seem unfortunate that the sponsors of the I.M.F. should not have prescribed any lines of policy for the member countries for the transitional period. In fact, the very phrase 'transitional period' can have no definite meaning unless one assumes that it is just the time necessary to enable each country to put its own economy on an even keel so as to remove the discrepancy between the internal and external values of its currency.

## 3. *The Problem of the Parity of the Rupee*

In deciding the exchange value of the rupee, there are thus two problems to be considered : (1) what shall be our currency and exchange policy immediately after the war, i.e. during the

transitional period ; and (2) at what rate should we stabilise the rupee when we are called upon to join the I.M.F., if we join or have to join at all. The latter question cannot be answered at present, just because of the difficulties mentioned above. The existence of all sorts of economic controls has brought about in all countries a disequilibrium between the level of prices and costs ; secondly, in all countries there is no correspondence between the internal value of the currency unit and its external value. This means that the problem of choosing the right parity is going to be a delicate one for all countries. Clearly, there can be no question for us at this stage of deciding what the rupee-sterling-dollar parity should be. We may make guesses about the future price trends in U.K., U.S.A. and in India ; we may try to estimate the possible depreciation or appreciation of the pound in terms of the dollar ; we may try to allow for fundamental changes in the relative productive efficiency of different countries and especially the strength or weakness of their future balance of payments position. But, all this cannot get us very far ; it cannot give us a precise parity at which to stabilise. Discussions of these matters at the present juncture can only be—in diplomatic slang—exploratory in character.

No wonder that those who have speculated on this question have given different answers. Some have recommended a substantial depreciation of the rupee ; some have even asked for—or at least given the impression of asking for—an appreciation ; others have preferred the existing rate ; and some have—rightly, so far as we can see,—taken up a non-committal attitude.

The question, let us repeat, that we must address ourselves to immediately is as to our policy in the immediate post-war period. What should we do *immediately* on the cessation of hostilities ? Should we depreciate the rupee ? Should we adopt a higher ratio ? Or, should we keep the present one ? Should we, in other words, maintain any particular ratio at all and let economic forces express themselves through, and adjust themselves more or less automatically to, this ratio as best as they can ? This is, for us, the crucial question. Even so, there are many imponderables in the situation, and he would be a bold man, indeed, who ventured to lay down a solution dogmatically. Let us see, however, if we can size up

some of the forces that we would have to take into account ; let us see if we can get some clarity about the various issues involved.

The difficulty is that any currency-and-exchange policy you lay down is bound to benefit some sections of the community and affect others adversely. One has, therefore, to attach weights to various interests ; it is that dreaded spectre of inter-personal comparisons, on which many wise economists would prefer merely to shake their heads !

#### 4. *The Present Position*

Let us start with the facts as we know them. The note circulation in India increased from Rs. 179 crores in September 1939 to Rs. 1010 crores by the end of 1944—an increase of 464 per cent. This process is evidently to continue for the duration. By the time the hostilities cease, even if they cease say, by the end of 1945, the note circulation would have gone up to much above Rs. 1000 crores. The current deposits went up from Rs. 134 crores in September 1939 to Rs. 616 crores in December 1944, but their velocity of circulation went down by over 45 per cent between 1939-40 and 1943-44. During this period, the price level increased from 100 for the week ending 19th August 1939 to 245.2 in November 1944 according to official index numbers ; the black market prices are substantially higher. The cost of living index (Bombay) with 100 as the base in 1939 had increased to 233 by August 1944. The effects of this currency expansion have been held in check by (a) some hoarding of currency, (b) idle bank deposits, (c) price control and other restrictive measures adopted by Government and only slightly, by (d) increased production and employment. The continued expansion of currency has thus weakened the rupee internally, but this has not been manifested in its external value because of the operation of exchange control and other difficulties in the way of foreign trade. In fact, externally the rupee is stronger today because of the extinction of our sterling debt and therefore the saving of interest charges and by the accrual of sterling balances amounting to Rs. 1000 crores at the credit of the Reserve Bank of India. If our intention was merely to earn interest on these balances and if other things remained the same, we could easily estimate to what extent our balance of payments position would

be improved after the war as a consequence of these changes. Actually, however, we would like to draw upon these sterling balances in fairly large amounts for the next ten years or so, so as to get our plans going. Besides,—an equally serious matter—the high level of costs and prices brought about by this inflation has reduced our capacity to export. Moreover, the economic conditions in the post-war world are going to be so different from those in the past, that one does not know where exactly we shall stand in respect of our capacity to import as well as to export. The desirability or otherwise of currency depreciation can be judged perhaps without much difficulty if we had to take into account merely the reciprocal elasticities of demand-and-supply. Here however, it is a matter of judging the extent and direction of *shifts* in these magnitudes, which is, few would doubt, a very risky affair, indeed.

#### 5. *Monetary Expansion in U.K. and U.S.A.*

But, let us persevere with our facts. The following table shows the expansion in note issue and bank deposits and the rise in prices and cost of living in U.K. and U.S.A. since the outbreak of the war.

It appears from the table, firstly, that (1) -the percentage rise in prices in both the countries has been very much less (72% and 36% respectively) than the increase in monetary circulation (112.5% + 92.6% and 197.2% + 119.2% respectively) which may be taken to show partly the difference in the efficacy of controls, partly the difference in increases in production and partly the difference in currency hoarding. Which of these factors has actually been more prominent relatively to the others in either of the two countries it is difficult to say. On the face of it, it is clear that the relative increase in production in U.S.A. has been greater than that in U.K. ; but that on the other hand, the efficacy of controls may be expected to be lower in U.S.A. because of its peculiar banking and administrative system which is complex and cumbrous. This latter is probably borne out by the relatively greater rise (42%) in food prices in U.S.A. than in U.K. (24%). It does not seem possible even to hazard a guess regarding the extent of hoarding in the two countries either in the form of cash or of liquid bank balances. From these facts, taken by themselves, it is not easy to measure the inflation potential of the two countries.

Year and month	Notes in Circulation (Total including coins)		Demand Deposits		Wholesale Prices Jan-June 1939 = 100		Cost of Living Jan-June 1939 = 100		Retail Food Prices Jan-June 1939 = 100	
	U.S.A. Mns. of \$	U.K. Mns. of £	U.S.A. (Member Banks) Mns. of \$	U.K. Mns. of £	U.S.A.	U.K.	U.S.A.	U.K.	U.S.A.	U.K.
1939 2nd half	7,598	554.9		1398	103	112	100	108	101	110
1940 1st half	Dec.			Dec.	103	134	101	117	102	119
1941 2nd half	8,732	616.9	33,528	1770	103	147	101	124	102	125
1941 1st half					109	155	103	129	106	125
1942 2nd half	11,160	751.7	38,845	2168	120	159	108	130	117	121
1942 1st half					128	163	114	130	126	118
1942 2nd half	15,410	923.4	54,523	2429	130	165	118	130	136	118
1943 August									150 <sup>June 43</sup>	119
December	20,449	1088.7	65,438	2712	135	167	122	129	145	122
1944 January	20,529	1067.3		2650	135	168	123	129	145	124
March	21,000	1104.6		2652	136	169	123	130	144	124
May	21,552	1135.5			136	170	123	130	142	124
June	(April)		73,488		(April)	172	124	130	142	124
July	22,584	1150.5 (20.9.44)				172	(April)	130		124
Percentage of increase over the 1935 figures.	197.2%	112.5%	119.2%	92.6%	36%	72%	24%	30%	42%	24%

Secondly, the table shows that the wholesale price level came to be almost stabilised in U.K. about the end of the first half of 1942 and in U.S.A. about the middle of 1943. The cost of living index shows stability in the case of U.K. since the second half of 1941 and in U.S.A. since the second half of 1942—again a lag of about one year. The limiting factor, however, would be the prevalence of black markets, the extent of which cannot be gauged. Even here, therefore, it is not easy to judge the relative depreciation of the two currencies in terms of their internal purchasing power and therefore of their relative appreciation or depreciation in terms of their external values.

Thirdly, the table brings out the fact that the relative expansion of monetary media since the stabilisation of prices in the two countries has been uneven. In U.K. the note circulation increased from £923.4 million in the second half of 1942 to £1150.5 million by September 1944, an increase of 24.6 per cent; in U.S.A. from \$15,410 million in the second half of 1942 to \$22,584 million in July 1944,—an increase of 46.6 per cent; the corresponding increases in demand deposits in the two countries were from £2,429 million to £2,652 million (March 1944)—an increase of 9.2 per cent, and from \$54,523 million to \$73,488 million—an increase of 34.8 per cent. Production had been stabilised in both countries by the end of 1943. The peak point of industrial production was reached in U.S.A. in October 1943 when it was 128% more than in 1939. The index of income payments in U.S.A. in April 1944 shows an increase of 117 per cent over the 1939 average while the weekly wage index in Great Britain has risen by only 41.5 per cent. This gives us some idea of the inflation potential, which may be taken to be higher in U.S.A. than in U.K. This implies that (a) if the cessation of hostilities was to come about immediately, and (b) if controls were at the same time relaxed, there would be a higher rise in prices in U.S.A. than in U.K.

The fact, however, is that neither of these assumptions is true. The European war, we are told on authority, will last longer than we had expected, and no one knows what would be the duration of the war with Japan thereafter. Moreover, we do not know how the monetary expansion as well as the other indices would behave in the two countries during the further period of the war and

whether the scale of expenditure of U.K. would be relatively lower than that of U.S.A. It is also unrealistic to assume that controls will be relaxed in the two countries immediately after the war, and it is still more difficult to say which will be relaxed when and by what stages.

### 6. *Sterling-Dollar Parity*

It appears, however, that, on the whole, if the war lasts long, the inflationary tendencies in U.S.A. would gather further strength and the pound may then find itself less over-valued in terms of the dollar. On the other hand, however, there are so many factors in the situation making the pound weaker that on balance, some depreciation of the pound may prove necessary. It is doubtful, however, if, in those circumstances, Britain would choose—and U.S.A. would allow—a depreciation of the pound in terms of the dollar or whether attempts would be made, through loans, to prop up the pound against the dollar.

Further, there is also the fact that calculations in terms of purchasing power parity are notoriously slippery. One does not know the velocity of adjustments of costs and prices in the countries concerned, and there are some theoretical difficulties about the use of this criterion.

All this, therefore, does not give us any precise indication of the right parity between the pound and the dollar on the cessation of hostilities, much less any idea as to the proper relationship between the rupee and these two currencies. Whether we would have to settle only one parity and the other would be automatically settled through the sterling link is another question.

### 7. *Shift in Relations between Countries*

These, however, are by no means the only factors to be taken into account. There is the further fact that during the war a major change has come over in the creditor-debtor relationships of these countries and also in the general factors shaping their balances of payments. Britain will emerge a heavily indebted country with her export capacity vastly impaired. U.S.A. will be a strong creditor country but in what shape she will choose to receive payments—if any be forthcoming—from her debtors is also going to be a problem.

Will U.S.A. maintain tariffs to avoid unemployment at home? Will she lend liberally to war-devastated European countries and industrially backward countries to rid herself of the bother of having a persistently negative balance? One does not also know whether and to what extent the Lease-Lend arrangements will continue after the end of the European War; nor does one precisely know how and to what extent these obligations will have to be met after the war. There is also uncertainty about the possibilities and directions of international economic co-operation in the post-war period by way of a reduction of tariffs and a relaxation of exchange controls and other hindrances to multilateral clearing, not only for current balances of indebtedness but also for the so-called abnormal war balances. The imposition of reparations on Germany in cash and/or in kind may complicate the matter further.

On the whole, therefore, it would be hazardous even to think in terms of some particular ratio of stabilisation for the rupee in the near future, much more to try to state it in quantitative terms.

## V. THE FUTURE OF THE RUPEE : GUIDING PRINCIPLES

In view of the above, all we can do, it seems, is to formulate in general terms, in the light of circumstances we can appraise at present, the main principles according to which our currency-and-exchange policy ought to be steered in the immediate post-war years.

### 1. *An Autonomous Rupee*

First and foremost, it seems necessary that the rupee should be de-linked from sterling, for the time being, at any rate, and the Reserve Bank should determine its external value from time to time in view of the requirements of domestic policy and the actual conditions in the international money markets. The requirements of domestic policy under a system of Planning should guide economic policy in this as in other spheres; the uncertainties in the international economic and financial relations are obvious, and unless we free ourselves from them, no planning may be possible. The regime of exchange control will thus have to continue, and also one is constrained to add, bilateral clearing arrangements. This may sound reactionary to some, visionary to others, but there seems to be no other way. We must have an autonomous rupee in the

transitional period as a first step towards stabilisation. If the Reserve Bank adopts a strong line of policy, there is no fear now that this de-linking of the rupee from sterling would mean a loss of confidence in the rupee. The Indian public has known during the war that the sterling balances in London, which cannot be drawn upon as and when we like, do not really give strength or stability to the rupee. The good old arguments in favour of a simple and easily comprehensible standard of currency hold no longer.

It is sometimes contended that the utility of such a policy varies inversely with the number of countries adopting it. Quite true ; but that is no excuse for India to be dragged behind another country's currency. Sitting on the fence and holding one's own as best as one can in the transition period is not a negation of internationalism or a denial of the excellent ideal of freer trade based on multilateral clearing. What matters is the time factor.

## 2. *Sterling Balances*

Secondly, the question of the repayment of our sterling balances has now to be settled bilaterally and we should take good care to see that the entire burden of the transfer is not thrown on this country alone. In plain language, this means that India should not be expected to maintain an unduly high exchange ratio in order just that she may have negative balances to wipe out her sterling accumulations. That there does exist a transfer problem cannot be denied, but just as this country would have to accommodate larger net imports in order to be able to utilise her sterling assets, so too Britain must create a larger export surplus at home, not by artificially under-valuing her currency but by the healthier method—in the long run in her own interest—of reducing export prices by increasing her productive efficiency.

While assuring the public that the payment of the balances will be honoured, the Viceroy recently suggested that in the actual settlement of the method of payment the interests of the planned development of India will be taken into account. This reinforces the above argument, if it means that the settlement will result in a bilateral trade agreement fixing so much of exports of capital goods from U.K. to India spread over a series of years as required by the

schemes of planning in India. This should not adversely affect the exchange position of either country, if the U.K. creates the necessary export surplus by increasing her productive efficiency.

### 3. *Optimum Price Level*

Thirdly, the Reserve Bank must form a tentative idea of the optimum price level to be attained in this country as soon as possible after the war. The inflation of currency during the war has hit the small man hard. Businessmen and industrialists with an eye on profits may like to keep prices somewhere near the present level and talk in terms of a large depreciation of the rupee. But, to an impartial observer, the present price-level is quite untenable and the fixed-income groups do deserve considerable relief. Moreover, an unduly depreciated exchange-rate raises the cost of imports, and this also should be a weighty consideration for us especially when it is proposed to import capital goods on a large scale.

The Reserve Bank will have to take into account the various factors that we have discussed above, such as the existing volume of currency, factors leading to a lower price level, those leading to a higher price level, external influences and above all, the requirements of planned economic life. This is the most important function of a Central Bank. Unfortunately this has been overlooked during the war, and shelter has been taken under the provisions of the Act which has been used to expand currency to a limit undreamt of by the authors of the Act. What was intended to be a check on uncontrolled inflation has been utilised as the very basis of such inflation! We would emphasize the need for amending the Reserve Bank Act so that such a misuse of the provisions may be prevented and the Bank be charged with the duty of not only finding the optimum price level for the country but using its powers to maintain it.

### 4. *Wait and See Policy*

Fourthly, we would have to watch carefully how the major countries of the world shape their currency-and-exchange policies in the post-war period. We are in a regime of what may be called oligopolistic competition in respect of foreign exchanges, and, under such conditions it pays to be a follower rather than a leader. Pre-

mature attempts at stabilisation in terms of any parity, the existing one or a new one, are fraught with danger.

In this connection, we may say that the requirements of the International Monetary Fund that each country should, on joining it, fix its parity is likely to create serious difficulties for India. So long as important currencies like sterling have not found their moorings and comparative stability in international relations has not been achieved, we shall be subjected to powerful and rapidly changing world forces in our economic life if we hasten to fix the parity of the rupee either with sterling or gold. We have merely to recall our own colossal blunder and misfortune after the last war when the rupee was sought to be fixed at 2s. gold at a time when the world currency situation was chaotic.

#### 5. *Depression and Cheap Imports*

Fifthly, there is a possibility that on the cessation of hostilities there may develop in this country a depression psychology, which, if unchecked, may land us into a slump. A reckless import of goods from countries already preparing for an export drive may complete the vicious circle by destroying the nascent industries that have struggled into existence during the war period and by creating large scale unemployment. A rigid exchange under these conditions would deprive us of a valuable corrective weapon.

This is not an imaginary danger. Signs are already visible that this may prove to be a difficult and uncontrollable problem if the authorities do not take prompt measures in time. Both the U.K. and U.S.A. are anxious to find large markets for their goods. The problem for us is which of these goods it is in our interests to take and which to restrict. If planned economic development has any meaning, we should have a proper selection of such goods which may enable us to have those which we do not produce, and thus fill a real gap. If cheap goods of the type that we are already producing or want to produce are allowed to come in without restriction, we shall find that our schemes of planning will be doomed to failure.

#### 6. *Internal Stability and Planning*

In the foregoing pages, we have specially emphasised the importance of internal economic conditions in this country which

should determine our monetary policy. Unless we keep this point of view in mind we are likely to be affected adversely by external forces to which the internal arrangements may have to adjust from time to time. Instead, it should be possible for us to adjust our external relations to our own internal economic condition. This is the point of view from which most other countries are likely to view internal arrangements. In the case of a country like ours, this point of view has still greater importance because of the need to adopt schemes of rapid, far-reaching, economic development. The various economic plans which are under consideration at present for the development of the country will involve rapid and widespread changes in the internal economic life of the country. Unless the monetary policy is controlled in the interests of a national economic plan, we may find that the plan itself may suffer in its execution. It is obvious that internal price level in the country will have a great effect on foreign trade as well as on productive capacity. Any economic plan will have to visualise the correct price level which will give an impetus to the production of the desired amount of both agricultural and industrial goods and at the same time enable us to have adequate markets for our surplus goods. If, instead of determining the price level from this all-important point of view, it is made subject to changes either because of its link with the sterling or because of other external forces over which we may have little control, we are bound to find our internal development plans hindered thereby.

In the nature of things, the plans for the economic development of the country will have to proceed on certain assumptions of an estimated price level on the basis of which the costs of implementing such plans will be worked out and the finance provided accordingly. For example, the Bombay plan estimates an expenditure of Rs. 10,000 crores on the basis of the average prices of the pre-war period, 1931-39. From the above discussion it is easy to say that we are not likely to reach the low level of prices prevalent during that period. To the extent to which the price level that actually exists in the country after the war is higher than the prices assumed in calculating the finance for the above plan, the amount required will be larger in proportion. This is pointed out in order to illustrate the way in which the actual price level in the country is bound to affect our plans for development. The same will be true of

schemes undertaken by private enterprise or of economic relations among the different sections of the public. Whereas, on the one hand, it may not be wise to maintain the price level at the height to which it has now risen, at the same time it may not also be possible to lower it to the pre-war level, because that would mean a severe deflationary process involving serious strains on the economic structure of society. Some *via media* will have to be found where the price level should be stabilised with the greatest advantage to the country. Those in charge of the monetary and financial destiny of the country will have a responsibility in determining this point at the opportune moment. They will have to take into consideration the existing condition of the country, its productive capacity, actual and potential, the needs of fuller employment, and the price and cost structure, as well as the various schemes for development, public and private, awaiting execution. The possibilities of trade with the outside world as well as the manner in which the liquidation of our sterling balances is ultimately arranged will also be factors to be taken into account. The statistical material needed for such a purpose will have to be more comprehensive and more reliable than what is available at the present moment. Those concerned will do well to devise prompt measures by which the statistical machinery of the country is adequately expanded so that the necessary data are available at the right time for a correct judgment of these difficult problems in the national interest.

It has been said in certain quarters that money should be made the instrument of economic progress and that we could 'create' money so as to stimulate production and employment. There is an element of truth in this contention, though there is an element of fallacy in the way the argument is often put forward. In any case, we ought not to forget that so long as money economy and the price mechanism continue to exist in a country, the most important objective of regulating money in the interests of the country is to stabilise the price level and it is the duty of the Central Bank to see that it does remain comparatively stable.

There are economists who have argued that even such a stability of prices may conceal within itself the germs of an inflation, if technical progress brings about a large reduction in real

costs. This, however, is a refinement about which we may not worry at this stage. Much more disturbing is the thesis that monetary expansion cannot cause inflation till there is full employment. This may be true in the case of highly industrialised countries where the factors of production are already in an employable form, but the same may not be applicable to our country where some resources are just latent and some are unutilised or underutilised because of sociological factors. It is erroneous to believe that the 'creation' of money can itself stimulate production so far as to make this monetary expansion neutral in its effects on the price-level. Whatever the case for a 'cheap' money policy in the interests of greater investment, this in no way lessens the need for maintaining the stability of the value of money if any sensible accounting is to be retained either for private individuals or for the planning authority.

In an emergency like the present, when the price level has gone beyond control, it becomes the duty of those in authority to watch for the opportune moment when the prices can be stabilised at a reasonable level taking into account the considerations referred to above. Once having stabilised the price level, it then becomes the duty of the Central Bank to see that it is maintained at a stable level thereafter as far as possible, consistently with the requirements of the scheme of planning adopted by the country.

Briefly, then, no country wishing to have a plan of economic development can afford to allow serious changes in its price level because such changes will disturb all the calculations on which the plan is based. Those who talk about 'created money' have to realise that the possibility of resorting to this device is limited by this fundamental requirement of a sound currency system. It is not wise to overlook this in the belief that we can remove the defects of 'created money' by price control in face of our daily experience of price control measures in the country at present.

From this point of view international economic organisations that are likely to come into existence after the war may or may not be useful to us according as they do or do not take note of our internal plans. Whereas it would be in theory desirable to co-operate with such organisations for international economic peace, statesmanship will require a wise reconciliation of possible conflicts between our national aspirations and such international commitments.

If, as is not unlikely, some of the international organisations are dominated by the point of view of the advanced industrial countries eager to obtain privileges and powers over different parts of the world, then the problem referred to above will be difficult to solve. If this is not resisted successfully by countries like India, all talk of economic progress within the country may prove difficult of realisation. If, on the other hand, the leading countries appreciate the fact that the needs of backward countries should be taken note of in international economic relations, there will be a possibility of arriving at an agreed solution in the common interests of all concerned.

### *Conclusion*

The above analysis shows how various factors, external and internal, will play their part in determining the future of the rupee and how those in charge of the destiny of this country will have to discharge the difficult task of determining the internal and external value of the rupee in a manner most conducive to the interests of the country. It will be their privilege to see that the economic energies waiting to be released and properly canalised for the onward march of this country are given the proper impetus by regulating the rupee in the service of such a desideratum. If either because of political or other external considerations, we fail to obtain in practice the correct valuation for the rupee both externally and internally, we should once again be prepared for a frustration of our cherished desires.

We therefore conclude that (1) it is too early as yet to define the exchange rate of the rupee at which we should, at the time of joining the I.M.F., link our currency to any international currency, directly or through sterling ; (2) it does not seem possible, in view of the many imponderables in the situation at home and abroad, even to lay down the rate at which we should allow unlimited exchange transactions in the transitional period ; (3) the advantages, during this period, of an autonomous rupee regulated internally and externally on a balance of all the relevant considerations, such as the internal price and cost structure, the current balances of payment and the settlement of sterling balances, far outweigh any disadvantages on account of a possible

adoption of the same policy by other countries—if only we know how to play the game and are allowed to play it ; and lastly, (4) we need to have much clearer ideas than we have at present regarding the monetary and exchange implications of large scale planning to which, we assume, we are committed in the interests of a substantially higher standard of living in the country through a full utilisation of our potential resources, natural and human.



