FINANCES OF THE GOVERNMENT OF INDIA

SINCE 1921

INDIA'S NATIONAL FINANCE

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Sir Kikabhai Premchand Readership Lectures

Delivered in 1932 at Delhi University

BY

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PREFACE.

THE following pages contain the substance of the series of the Sir Kikabhai Premchand Readership Lectures which, under the auspices of the Delhi University, I was privileged to deliver in February and March this year. The subject prescribed for the lectures was "the Finances of the Government of India since 1921"; and as coincidence would have it, it had to be discussed at a time when the Government and the Legislature of India were called upon to deal with one of the most critical situations in the history of the national finances of the country. My previous investigations had already taken me over a few important stretches of that history ("Gokhale and Economic Reforms" 1916, "India's War Finance and Post-War Problems" 1919 and "The Dawn of Modern Finance in India", 1922,); and now these Delhi University Lectures have enabled me to bring those studies up-to-date. I am deeply indebted to the authorities of the Delhi University for having given me this opportunity of reviewing the development of the national finances of India during the last eventful decade.

The ten years 1921-31 witnessed remarkable vicissitudes in the fortune of India's finances. The period opened and closed with a "crisis," and only five years between the two ends were comparatively free from disturbing conditions. I have attempted, in the following pages, to give a connected account of the origin of the crises and of the passage of the one into the other, showing how the transition took place, at each stage. The situation, as is developed, has been analysed at every important step, and the changes in and the working of the various factors involved, have been carefully explained. Thus the course of events with respect to the different aspects of national finance, such as revenue and expenditure, taxation and public debt, currency and exchange, railway finance and provincial finance, has been traced in detail and the total effect of these on the condition of the people has been indicated. The relation between the internal state of affairs and world conditions has been constantly kept in view, and Government's Policy underlying the management of the nation's finances has been explained and criticised. Ample statistical material has been supplied throughout so as to facilitate exposition and understanding.

Post-War years have been a period of extreme difficulty for almost every nation in the world owing to the general political and economic instability as well as financial disequilibrium. India had her full share in these troubles. We have had, besides, our special conditions and special problems to face. I have thrown the searchlight of close scrutiny on these developments and subjected Government's measures and policy with respect to them, to free and full criticism, having considered financial administration from the point of view of national interest and popular well-being. The crisis with which the decade under review closed, is still with us; and constitutional changes of a far-reaching character which have their repercussions on the system of national finance and the political effects of which on financial conditions are unmistakable, are impending. It is hoped that, in these circumstances, the scientific and practical treatment of a theme of such paramount importance, adopted in this book, will appeal both to the students of finance and to the wider reading public interested in the subject.

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1*st October*, 1932.

V. G. Kale.

CONTENTS.

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CHAPTER I.

THE DECADE UNDER REVIEW.

THEN AND NOW.

1. *Choice of Period to be Reviewed.*—It conduces to the convenience of a student of social developments to select his special facts and periods of time, to isolate them and to concentrate upon their scientific investigation. Only he must properly appreciate the inherent limitations of this method of study and be cautious in deducing conclusions. For, events are so mixed up together and are so closely interdependent that a chronological presentation of facts, their juxtaposition in an arbitrarily chosen period and generalisation from them, may lead anywhere or nowhere. But if these are examined in their appropriate perspective, the results are calculated to prove instructive. Reviews of events falling within comparatively long periods of time, *e.g.*, a century, are fruitful of substantial conclusions because there, intellectual and social forces have sufficient scope to work themselves out, and in this way, the 19th century, for instance, has been sharply distinguished from its predecessors in vitally important particulars. It is equally useful to draw the boundary lines of epochs with reference to movements embodying certain definite principles or policies or striking facts or tendencies which impart a unity to the periods over which they are spread. The Industrial Revolution, the Napoleonic era and the age of mercantilism, are examples of this second method. Shorter spans such as a year, a quinquennium or a decade, have this advantage that they lend themselves easily to an intensive study of facts lying within their limits though such investigations will often suffer from the defect of barrenness. For example, Indian statistics relating to economic conditions have been compiled and published, in many instances, so as to give a comparative view of the events of the pre-war, the war and the post-war periods. The last

of these, it was expected, would be a time of transition from abnormal to normal conditions; but unfortunately, as will be shown in the course of these chapters, the period has had an erratic career and has lacked the anticipated unity. Nevertheless, the decade in the history of the finances of the Government of India, which we propose to review, exhibits certain interesting features, an understanding of which may be expected to provide guidance in tackling the difficult financial problems which confront the country, at the present moment.

2. *The Decade under Review.*—Finance is ever a subject of absorbing interest to the economic investigator, and it is intimately connected with the vital interests of the citizen. The year 1921 opened a new era in the constitutional and the financial history of India, which, as we hope to be able to show, is well worth a detailed examination. In the decade 1921-1931 we witness in the general economic conditions as well as in the financial situation in India, a clear reflection of the posture of world affairs and can trace in them the working of the forces set in motion by the war and the consequences of the peace which closed it. Curiously enough, the decade begins in the midst of disturbed conditions and also ends in a state of serious disequilibrium, with a few years of calm coming in between. Starting the journey through the decade in discouraging circumstances, we clamber up the hill and hopefully view the landscape only to be dragged in a moment down the slippery slopes of depression. To vary the metaphor, after all the trials and tribulations of the early years of the decade, the ship of the financial state of the Government of India finds itself at the close of the period, in troubled waters again. External influences alone were not, however, responsible for the misfortune. Internal causes largely contributed to the result.

In 1930-1931, discussion had already started with respect to the development of the country's finances on an all-India federal basis and to the reorganisation of the nation's financial arrangements (which were to include Indian States), calculated to have far-reaching effects. But these coming events did not cast their shadows before in the sense of influencing the prevailing system, and the already difficult situation was not actually complicated by the introduction of additional elements of disturbance. Ten years before, however, in 1921, constitutional changes, known as the Montague-Chelmsford reforms, had already come into operation, bringing with them a new distribution of revenue and expenditure as between the Central and the Provincial Governments, and throwing upon the former the responsibility of doing away, in the course of a few years, with the contributions receivable from the latter, to make up the deficit which the reorganisation had created in the central budget. Though the obligation steadily to reduce and ultimately to wipe out the contributions from the Provinces would hang like the sword of Damocles over the head of the Government of India, and members of the central legislature representing provinces, that stood to gain by this process, would give no rest to the Finance Member of the Government of India in this matter, it was not a question of immediate concern so long as the central accounts showed huge deficits from year to year. It would be a problem of practical politics only when recurring deficits had been got rid of and surplusses had emerged in the exchequer of the Government of India. Nor were the constitutional reforms expected to exert any practical influence on the situation, as in the government at the centre, the element of popular responsibility had not been introduced, as it had been at least partially admitted into the Provincial Governments. Nevertheless, the Finance Member felt it necessary in 1921 to emphasise the significance of the change which the new dispensation of the Government of India Act had brought about in his position *vis a vis* the Indian Legislature in as much as except for certain specified items and subject to the Governor-General's power of certification—by no means unimportant exceptions—all proposals for expenditure embodied in the budget required the sanction of the Assembly and additional taxation could not be imposed without the assent of the Legislature. The public debt and ways and means position was a cause of anxiety as much in 1931 as in 1921, and the prospects for railway finance, which had not yet been separated in the latter year from the general finance of the Government of India, were far from being intrinsically satisfactory, both at the beginning and at the end of the decade though at the former time, railways were temporarily a very productive source of revenue. The central legislature, particularly the Assembly, was supposed, throughout the period, to exercise the influence, though not the control, of popular opinion on the Government administration of national finances over the entire field and was represented as a sharer in the responsibilities as well as the powers of the executive.

3. *Popular Control over National Finance.*—On the question of the relation between the executive management and the legislative control of the finances of a nation, it will suffice here to observe that however efficient the technical administration of national finance may be, it will not prove successful, in the broad sense of the word, unless it has the approval and the sanction of a popularly constituted legislature, exercising control over a responsible executive. The reason for this is obvious. The expenditure of Government depends upon the number and the nature of the functions it performs and the ideals and the policies the State adopts. The resources of Government being predominantly derived from the sacrifices of the people, the revenues of

the State will be adequate to its expenses only if those who determine national policies and give effect to them, are fully supported by the representatives of the bearers of the tax burdens. A complete accord between the responsible managers of national finances and responsible tax-payers, is an essential condition of the satisfactory administration of the economy of the State. Every constitution, indeed, has its strong and weak points, and the democratic form of Government has its dangers as much as the autocratic. Money may be expended where it should not be and may not be provided where it ought to be. The objects and the methods of taxation may likewise be unsuitable and undesirable, and public borrowings may be indiscriminate. Though a system of popularly controlled finance and one which is not subject to democratic control, both are liable to such faults, thinkers and practical statesmen have shown a decided preference for the former in view of its unquestionable superiority. Francesco Nitti, the famous Italian Professor and statesman, in his well-known work on the science of finance, (*Principes de Science des Finances*) has emphasised the proposition that arbitrary government and bad finance will always go together, while drawing pointed attention to the difficult problems which confront modern democracies, in the management of national finance. According to him, there are three important problems to face: first, to effect, in as large a measure as practicable, the separation of the three governmental powers, the legislative, the executive and the judicial; secondly, to have a stable and a technically well-ordered administration; and thirdly, to ensure fiscal justice and proper financial organisation in the distribution of national expenditure and of the burden of taxation. Nitti puts in a strong plea in favour of the parliamentary control of national finance and quotes Kant's illustration of the bird which, in the course of its flight, is tempted to curse the resistance of air, failing to understand that without that resistance it would not be able to fly at all, to demonstrate that the immense progress achieved by civilised countries during the past fifty years has been the result of the resistance to executive governments, of Parliaments, the press and public opinion in modern democracies.

4. *Sir W. Layton's View.*—That this discussion of the constitutional aspect of the financial organisation of government in general is not merely a digression into the realms of dry theory but has a vital practical bearing on the position of national finance in this country, is conclusively proved by the importance which Sir W. Layton, the Financial Assessor of the Indian Statutory Commission (commonly described as the Simon Commission), has thought it fit to attach to it, in his report. He lays down two propositions as the underlying assumptions of his conclusions, namely, "that it is both possible and desirable to improve the

economic and social condition of the Indian people by a substantial increase in expenditure on the "nation-building" services, and secondly, that it is possible, subject to the conditions already mentioned by him, to raise additional revenue for this purpose. It is not relevant here to offer detailed comment on these views. As a matter of fact, large additions have been recently made to the revenues of Government and to the public burden of taxation. What is specially germane to our present discussion, however, is the constitutional and political conditions in the midst of which the finances of India have been managed and controlled. In that connection it will be instructive to quote two passages from Sir W. Layton's report. According to him, the chief features of the financial situation in India are: "The mass of the people are extremely poor; that the country is incurring expenditure on primary functions of government, such as defence and the maintenance of law and order, as high in proportion to its wealth as western nations; expenditure on social services, such as education, health, sanitation, etc., on the other hand, is far behind western standards, and, indeed in many directions, is almost non-existent. The insufficiency to provide adequately for the latter classes of expenditure has been a factor of political importance in that it has created dissatisfaction with the very small headway that it has been possible to make in the direction of social amelioration under the Reforms."

5. *Non-responsible Executives and Powerless and Apathetic Legislatures.*—Among the reasons why little was done to increase taxation, as he would have it increased, Sir W. Layton gives the following:—"In the first place, new taxes must either secure the approval of the elected members of the provincial legislatures or of the Central Legislative Assembly as the case may be, or else must be raised by the exercise of the exceptional powers of the Governor or the Governor-General. Neither elected representatives nor the Government are willing to go very far in this matter. So far as the former are concerned, members of neither the provincial nor the central legislatures are willing to incur the unpopularity of voting increased taxation so long as there are no means of ensuring that the revenue will be spent on services which they might wish to develop or so long as it can be argued that resources might be obtained by reducing expenditure on services not under popular control, such as the police in the provinces and army at the centre. On the other hand, there is at present no provision in the constitution by which the central government could use its resources to subsidise the social services falling within the provincial sphere even if it wished to do so; and in any case there are very definite limits to the extent to which an irresponsible government can force increased taxation on a poor country. Hence, neither legislatures nor Government have been willing to take action." Without minimising the importance of the strictest

economy in expenditure and of the necessary efforts to reduce existing expenditure, particularly in view of the inevitable opportunities for extravagance associated with the system of non-responsible government at the centre and of dyarchical governments in the provinces, Sir W. Layton concludes that it is necessary so to order things that "responsibility for imposing additional taxation is definitely laid upon those who will have to incur additional expenditure." Another handicap from which Indian Finance has had to suffer, is a lack of harmony between the distribution of functions on the one hand and the allocation of sources of revenue to the provinces and the Centre respectively on the other. It has so happened that while revenues capable of expansion have been assigned, under the Montague-Chelmsford Reforms, to the Central Government, whose expenditure is expected to be stationary or falling, the sources of the income of the provinces, whose expenditure was bound to be on an increasing scale, were inelastic. And further, as the provinces found themselves differently situated financially, attention was more concentrated on securing a redistribution of resources rather than on increasing the total available funds. It is not necessary to pursue the discussion of this subject here, especially in view of the fact that provincial finance does not directly fall within the scope of our enquiry. And it will serve the purpose of bringing out the special significance of the question under consideration, if we briefly indicate the main features of the constitutional and the financial position of the Central Government. The executive power of raising and spending national revenues has not been under effective popular control, and, therefore, the prospects of successful financial management have been minimised; and this observation covers the whole range of national finance, including railways, currency, exchange and public debt. As a matter of fact, the Reforms of 1921 were regarded and often described, as an experiment; and it was obvious that a non-responsible executive confronted by a non-official, elected majority in the Legislature, would not make the management of national finance, a success. This handicap was associated with the administration of the finances of India throughout the decade of our review. Under the Meston Settlement, there were allotted to the Central Government sources of revenue which were calculated to enable it not only to keep its normal business going but to reduce and ultimately to forego the provincial contributions. This that Government did succeed in achieving in the course of a few years, but it could do so mainly by first putting on additional taxation to meet recurring deficits and then maintaining that high level of taxation even when there was a general improvement in economic conditions.

6. *Abnormal Conditions at Beginning and End of the Decade.*—Another striking feature of the beginning and the close of the

decade under review, is the fact that at both ends the management of national finance has had to be carried on in the midst of abnormal circumstances relating to affairs, international and national. Revenues of Government depend, it should be noted, almost exclusively upon the spending and earning power of the people, that is, of the tax-payers. Sudden and marked changes in the price level, for instance, will set in motion a chain of influences that must ultimately produce an adverse effect upon the national exchequer. Rising prices will create boom conditions; but this spell of economic and financial prosperity is often immediately followed by a depression. The fall in prices associated with the latter, will affect the balance of trade, industrial profits and wages, and will act adversely upon foreign exchange and internal currency. It will tell upon railway traffic and receipts; and customs revenue and the yield of the income-tax will suffer. Government revenues falling short of expenditure, there will be deficits in the national budget, and additional taxation will become inevitable; and the State will be driven to resort to temporary and permanent borrowing. Exchange and currency will have to be suitably manipulated to enable remittances to London being effected, and borrowing in the London market will be unavoidable. And if the disequilibrium is due mainly or very largely to international complications and world causes, the difficulties of the internal situation are sure to be aggravated. It would be interesting to ascertain how India's national finances fared under the influence of the chain of cause and effect set out above, at the opening and at the close of the second decade of the current century.

7. *A Short-lived Boom.*—The early years of the decade were, for India, years of economic and political disequilibrium,—of a transition from an industrial boom to depression, deficits and dead-weight debts. They were years of uncertainty, anxiety and suffering. During the period of a war, there is always an appearance of all-round prosperity, prices and profits being high, and almost every one is found to suffer from the delusion that the good times are going to last for ever. Expectations and commitments are on a high scale, and when the inevitable crash comes, the disillusionment is painful in the extreme. By the fourth year of the Great War, the central revenue receipts exceeded those of the year 1913-14 by £22, of which about £9½ millions was due to additional taxation, and of the remaining £12½, about two-fifths was accounted for by increase in net profits on Railways. In the meantime, expenditure had increased by £19 millions, of which £9 millions was the share of military charges, increased by war, and £6 represented interest and sinking fund charges in respect of India's war contribution to Great Britain. Payment in London for expenditure incurred here on behalf of His Majesty's Government led to large accumulations of funds at

that centre, which proved extremely embarrassing, with inevitable adverse effects on our currency. When the war was over in 1918, the transition from the "unhealthy prosperity" associated with it, began. But the process of normalisation was hindered by the general high level of prices accompanied by scarcity in parts of the country and the calamity of influenza which spread havoc over the land. A duty on excess profits had to be levied to make the two ends meet during the year 1919-20. Difficulties connected with the large increase that had taken place in the paper and the rupee currency, and in the floating debt, continued to give trouble in the meanwhile. The budget estimates for that year were further disturbed by an unexpected war which had to be undertaken on the north-west frontier of India to repel an invasion from Afghanistan and to quell trouble among the border tribes, and a large deficit was the consequent effect. It was likewise a year of feverish company promotion, industrial speculation and exchange instability, which last was attempted to be remedied by the fixation of the rupee-gold ratio at 2 shillings. This high ratio, it was thought, would enable Government to make considerable savings on remittance operations and even to contemplate the entire extinction of provincial contributions within a measurable time.

8. *The Inevitable Depression and the Tale of Woe.*—But the sky became suddenly overcast in 1920-21, the financial situation was covered with a thick gloom and the vision of sunny days vanished like a pleasant dream. In March, 1921, the Finance Member stated that there had been only two clouds on India's financial horizon, viz., the legacy of war finance and the continuance of internal high prices, necessitating a wholesale revision of pay of public servants; and it was hoped that with the maintenance of the prosperity of the previous year and the natural increase in public revenue, the future could be faced without fear or misgiving. While imports, the fruit of temporary war prosperity and boom speculation, continued to pour into the country, the exports declined owing to small demand abroad, and thus the balance of trade swung to the unfavourable side. To add to this difficulty, the Indian monsoon of 1920 proved poor and disappointing. The persistent attempt to maintain the new exchange ratio, turned out a disastrous failure and only aggravated the economic and financial uncertainty which prevailed all round. Military charges, increased by frontier operations and by the legacy of the war, resulting from financial obligations deliberately undertaken by Government on behalf of India, were still on a high scale and the return from the Railways was very poor. Nearly Rs. 19 crores had, therefore, to be found by means of additional taxation to fill the gap between the income and the expenditure; and the ways and means could be provided largely with the help of the issue of paper currency against *ad hoc* securities. The Finance Member had a dismal

tale to tell of his stewardship, in March, 1922. The preceding year, he stated in his budget speech, would show a deficit of no less than Rs. 34 crores and the total for the four years since 1918-19, would amount to Rs. 90 crores. The deficit for 1922-23 was again estimated to mount to Rs. 34 crores and the whole of it, it was not possible to cover even by means of the additional taxation of all kinds that was proposed. World economic conditions were discouraging and the internal economic and political situation was equally bad. Government could only watch the dark horizon with concern and wait for the clouds to lift. The public could not, however, be expected to take up such a philosophical attitude and remain content with the consolation that India was merely sharing a world calamity and that there was nothing to do except to grin. The situation had become so intolerable that drastic retrenchment in expenditure was demanded, and then came the "Inchcape axe." Government had to swallow the bitter pills administered by the Retrenchment Committee as its own actions could not, even at a distance, approach its professions in favour of substantial cuts in expenditure. The nation's financial position slowly improved in the course of the next few years, and the very year 1923-24 showed a distinct advance on the path of recovery.

9. *The Story Repeated in* 1930-31.—We have observed above that the close of the decade under review betrayed economic and financial conditions very similar to those prevailing at the beginning of the period. The difference between the two is indeed one of degree rather than of kind. The opening paragraphs of the budget speech of the Finance Member in 1931 contain the following sentences:—"We meet in circumstance of great difficulty and that the responsibility of which I have to render account to-night is a heavy and perplexing one..... Times are bad . . . India is not alone in this economic adversity. It is a condition through which the whole world is passing, and I am convinced that the state of many countries is, beyond all comparison, worse than that of India..... The country has been through such times before. Economic life, at least in the modern world, moves in cycles or with ebb and flow. We are on the ebb now, but it is a safe prophecy that the tide will turn." At the end, as at the opening of the decade, world conditions and conditions within India, were disturbed, and reflected the critical time through which this country, along with the rest of the world, was passing. The Finance Member pointed out that in India we had an additional complication, *viz.,* that we were in the midst of great political unrest and stood on the eve of a fundamental change in the system of Government. There was an intense trade depression and a heavy fall in prices, particularly those of primary agricultural products. Confidence in India, as a field for investment, both at home and abroad, had been shaken, to the detriment of public as well as

private finance. External and internal trade was in an unsatisfactory state. Railway finance was in a bad way and was bound, indirectly, if not directly, to affect general national finances, seriously. The upshot of all this was that the anticipated small surplus was converted, according to the revised estimates for 1930-31, into a deficit of no less than Rs. 13½ crores. For the year 1931-1932, after the results of all contemplated economies had been taken into account, there was still a big gap of another 13½ crores between the estimated revenue and the estimated expenditure, and there was nothing for it but to fill it with new taxation. As in 1922-23, there was the talk, on the Government side, about still further and more permanent economies that would be demanded by the public and of a retrenchment committee to be appointed to explore the possibilities of the reduction of expenditure; and the Finance Member indicated the scope and the nature of the economies that were practicable.

10. *The Theory of Economic Cycles.*—In 1921, we were so near the close of the War and were so involved in the complex of the conditions representing the conversion of a big boom into a distressing depression that a return to the normal was anticipated as a matter of course, in a year or two. In 1931 too, a similar view was taken of the crisis through which India, along with the other countries of the world, was passing. We shall have later something more to say on this subject of the universal crisis through which the world has been passing since the end of the great War generally and during the last three years particularly. It will suffice to state here that the "ebb and flow" theory of the crisis, which is the standard economic theory of what are known as "Trade Cycles" or "Trade Fluctuations," adopted by the Finance Member, has only a limited application to the prevailing economic and political conditions. It is true, as the Finance Member has recently observed, (to repeat what has been already quoted) that "economic life at least in the modern world, moves in cycles," and the faith breathed by his words, "we are on the ebb now, but it is a safe prophecy that the tide will turn," cannot be declared to be unwarranted, when one is dealing with the ordinary course of national and international economic life and is referring to a short period of time. But as experience has now convincingly demonstrated, the crisis of the past few years is a phenomenon of an entirely different character, and it was exaggerated optimism in 1930 to have expected any thing more than a mild turn of the tide in the immediate future. A Finance Member, whose job requires him to think in terms of short periods and more of the immediate position than of the near past and future, generally tempers caution with optimism, and will resist the drastic application of the axe of retrenchment and economy with the plea that such an operation may do more harm than good to the permanent system of national

finance while he will plead for additional taxation as an essential condition of sound and far-sighted finance. It was with this view that popularly demanded retrenchment was described as indiscriminate axing and was deprecated both in 1930 and 1931. In the latter year, the Finance Member observed as follows with regard to this subject:—"In normal times expenditure inevitably grows from year to year. Then, for some reason or other,—generally an economic crisis with a sudden drop in revenue— the burden becomes too heavy to be borne and there is a sudden demand for retrenchment. In such cases of emergency, the axe is often wielded with a view rather to immediate than to remote results. Indiscriminate cuts are made regardless of their effects—officials are discharged, and thereby additional pension charges are permanently incurred—and then when the sudden feeling of enthusiasm has calmed down, and the crisis is past, it is found that essentials as well as non-essentials have been cut away."

11. *The Four-fold Problem.*—As we shall have to travel beyond the limits of the decade which it is the object of these chapters to review and to tread upon the treacherous ground of the discussion of the controversial topics of the day, if we were to deal here adequately with the issues raised in the above remarks, we shall content ourselves with observing that, since a reference to such topics is nevertheless essential for a clear exposition of the subject in hand, though indiscriminate cuts in expenditure, which would ultimately prove to be false economy, must be resisted, national expenditure has, at any rate, to be adjusted to the paying capacity of the people, ascertained by a close observation of economic conditions prevailing in the country for some time and of their probable trend in the near future. The Government of India could not have been unaware of this necessity and of the full significance of the problem confronting them, though the consciousness might not have been translated into action, as expected. The budget speeches of the Finance Member afford us glimpses of the recognition that Government's difficulties in the crisis at the close of the decade had to do with the legacy of preceding years, as well as with the anxiety to prepare for the transfer of management of national finances to the hands of responsible ministers, under the proposed new constitution. Internal political troubles and external economic disequilibrium were additional elements in the situation which tended to defeat the hopes of successful financial administration; and these were repeatedly emphasised on the side of Government. There were thus four different factors which invited consideration. As regards the first ingredient in the problem, the Finance Member, in 1930, raised the question "whether the gap caused by the final remission of the provincial contributions in 1927 had been filled or whether the time had come to recognise that it had not been filled and that it would be necessary

to find some new source of revenue," and he definitely answered it by saying that the gap had not been filled. As to the second element, and to the third which naturally goes with it, Government appealed for all-round co-operation in the task not only of correcting the disturbed financial equilibrium for the moment but of providing for prosperity for the future, particularly in view of the clamant needs of the Provinces when the transfer of responsibility came to be effected. The discussion, in the early part of this Chapter, of the constitutional and the political aspect of financial organisation and management has already covered the relevant features of these issues. And whatever views one may hold with regard to them, the fact remains that financial administration, however well-meaning, honest and technically efficient, must prove unsatisfactory and barren of appreciable advance in the path of progress, in the absence of a substantial accord between executive government and public opinion. Disturbed conditions in the outside world, over which we have no direct control, stand on a different footing, but even here, Government have to try their utmost to adjust national conditions to external changes by means of well-thought out policies and bold and judicious methods. The recent departure in Great Britain from the hoary tradition of free trade may be an eye-opener to some in this connection. To others, it is only a confirmation of an old conviction. In any case, it points an important moral to administrators and statesmen in India.

12. *Conclusion.*—In the beginning of 1931, the Government of India had not only to provide for additional income to meet an anticipated deficit but to face a difficult situation as regards their capital transactions and their operations as the national currency authority. The position of railway finance was equally bad, if not worse. The revised estimate for 1930-1931 revealed in the railway accounts, a deficit of nearly Rs. 11 crores, including the annual contribution to general revenues, amounting to half of that total. The separation of railway finance from general national finance is often likely to obscure the effect of deterioration in the former on the position and the prospects of the latter. But it is obvious that an economic crisis of enormous magnitude like the present, is bound prejudicially to affect the State's commercial undertakings and to damage national finance as a whole. In fact, the two are symptoms of the one and the same disease. When revenue does not come in in accordance with expectations, and trade conditions do not favour the easy remittance of funds to London, floating debt increases and exchange and currency have to be suitably manipulated, with the result that an additional burden is thrown on the exchequer and private trade and industry are likely to be inconvenienced. The closing year of the decade was full of these disturbing elements as much as the opening year, and there was little in the near prospect out of

which reasonable hope could be extracted. And the question uppermost in the minds of many thoughtful people was whether the situation did not require drastic and determined efforts to retrieve it and whether tinkering with it in the expectation that something would turn up, would not lead to disaster.

In 1921, the Finance Member, (Sir Malcom Hailey), made the following interesting remarks at the close of his melancholy tale of the national finances, unfolded to the first Legislative Assembly:—"But for myself the regret which I feel is not at having to announce a deficit or propose fresh taxation: my regret is that this Assembly should at the outset of its career be forced to face problems for which I feel that it can find no solution which will not bring it some unpopularity in the country. I believe wholeheartedly that the immediate political future of India depends on the strengthening and consolidation of the forces now represented in this Assembly. It is an unkind stroke of fate that circumstances should force us to place on this Assembly a burden which would be no easy one for a body occupying a position compacted by tradition and fortified by a long career of national service. But regrets will not cure hard facts. Circumstances have turned against us, as they have turned against so many countries last year and the circumstances must be faced. But let us bear in mind, that in proportion as we confront our present difficulties with courage and with breadth of vision, by so much shall we justify this, the first Imperial Assembly, to those who will come after us, the future Assemblies of a greater India."

Addressing the Assembly in 1931, the Finance Member, (Sir George Schuster), made the following appeal:—"We in the present Government appreciate the task, but I would ask the public also to appreciate our special difficulties at the present juncture. We are in a sense in the position of managers of a business, for which a change of management is under discussion. On the one hand, whatever steps we take now will affect the position of our successors; on the other hand, the value of the steps which we may take depends on how far our successors will be guided by those principles on the maintenance of which the success of any policy depends. The transfer of management can not be immediately effected, and upon us rests the responsibility of carrying on during the period of preparation for such transfer. In such circumstances, in the case of a business, if I may continue the analogy, the parties concerned, if they were upright and sensible men, would surely say: "We must co-operate during the period of preparation......" Such co-operation is particularly necessary just now, for the business which is to be transferred is having to face very adverse world conditions and to go through very difficult times."

In 1921 and in 1931, we have thus practically the same economic and political conditions in and outside India and the same appeal for co-operation and harmony, addressed by an executive government, not responsible to the representatives of the Indian people, to a legislature, devoid of the power of control. In the earlier year, the assistance of the public was sought on the ground that a great experiment in constitutional reform had to be made successful in difficult times; and in the latter year, the plea was based on the anticipations of further and more radical reforms that were being discussed, in trying circumstances. The financial situation, therefore, both at the beginning and at the close of the decade of our study, was full of uncertainty and tension, economic and political. We have attempted a very rough outline of the decade, 1921-31 in this Chapter, and shall now proceed, in the next, to fill in the more important features, undertaking, in the course of the subsequent Chapters, the task of giving detailed touches to the picture.

CHAPTER II.

THE THREE DISTINCT PERIODS IN THE DECADE.

1. *Montague-Chelmsford Reforms.*—It can be claimed for a study of India's national finances during the decade 1921-31, that its importance lies, among other things, in the fact that it covers a period in which the Montague-Chelmsford Reforms were in operation and at the close of which a further constitional advance was anticipated. The Reforms inaugurated in 1921 introduced into the constitutional and the financial machinery of Indian Government, certain changes whose working was calculated to provide an interesting subject for investigation, especially in view of the further and more radical changes contemplated at the end of the decade. Such an enquiry, being also a statutory obligation, was in fact, undertaken, by a commission for the information and the edification of the British Parliament whose privilege it would be to determine and sanction what it regarded as a necessary and a safe advance in the constitutional and the financial organisation of India. A unique interest has likewise been imparted to this subject on account of the possibilities that have been opened for the creation of an all-India federation, including Indian States, by the discussions at the Round Table Conference and outside. The decade 1921-31 may indeed be usefully reviewed from the above standpoint, but this cannot be done to the exclusion of other aspects of finance; and the question relating to the remission of Provincial contributions including as it does, the problems of central expenditure and taxation, has to be examined in relation to others, *viz.*, the management of the State Railways, currency and public debt so as to obtain a comprehensive view of the whole system as it has been worked in the course of the period. The economic and the political developments in the country with which the state of national finances is intimately bound up, will likewise claim our attention in so far as they have exerted any appreciable influence on the peculiar trend of the Indian Government's financial management during the decade. Economic and political forces which are always in operation in the country and outside, are seen powerfully to influence and complicate the normal course of national finances, and these are apt to render the choice of the series of years selected for examination, otherwise largely homogeneous, arbitrary and barren of substantial conclusions.

2. *The Decade,* 1921-31, *not Homogeneous.*—The choice of the period to be surveyed, may be based on a variety of principles. The decade is a conventional and a convenient span, neither too long nor too short, and has reference only to passage of time and takes no account of the character and the scope of social movements of the period. A division of time may also be selected because its commencement marks the initiation of some important reform or experiment in organization; and it is intended to watch its progress during a definitely fixed interval. Or, a period may be chosen for the fact that it represents the completion of an economic "cycle" and may be distinguished from the preceding and succeeding periods for similar "cycles". The years 1924 to 1929 thus constitute a "cycle" in the history of Indian finance which has a unity of its own. By the year 1924, the direct influences of the war and the post-war periods had almost exhausted themselves and general conditions were propitious for the work of stabilization and reconstruction. The next five years appeared to be years of normal growth, undisturbed by abnormal conditions of a serious character and gave promise of opportunities for a substantial measure of economic and financial achievement. But in 1929, the influence of disturbing factors began to be felt again, and it steadily grew in intensity till at last the country found itself in the midst of a serious crisis in the course of the next two years. With that year, a new economic cycle seems to have commenced, and its progress and end are to-day shrouded in uncertainty. It will thus be seen that the decade 1921-31 is not a homogeneous period of time and embodies no definite quantity or quality of results achieved. It begins with the close of one epoch and closes with the beginning of another, and between the two ends, there is sandwiched a span of six years of comparative stability and quiet. As such, the decade is nevertheless calculated to demonstrate the strength and the weakness of India's economic and financial position in varying circumstances, to reveal the merits and deficiencies of her national policies and to point the right path of healthy development and progress. The variety of experience embodied in the decade affords interesting material for fruitful study and will compensate for the lack of unity in the period.

3. *Three Divisions in the Decade.*—The above narration of events naturally leads to the conclusion that it will be convenient to divide the decade into three distinct periods: the first, consisting of the years 1921-22 to 1923-24; the second from 1924-25 to 1928-29 and the third, from 1929-30 to the present day. It may be incidentally mentioned that, as accident would have it, the three periods are associated with the names of three different custodians of Indian finance. During the stormy period of the first two years, Sir Maclom Hailey was at the helm of affairs; Sir Basil Blackett was in charge in the second, the most fortunate period

of the three; and Sir George Schuster has been responsible at the close. We have now to see in what sets of conditions these Finance Members had to work, what problems were set before them and how they tried to solve them. The most convenient procedure to follow in this regard, will be, first to take up the three periods separately and successively, to scrutinise the main aspects of national finance such as expenditure, revenue, currency, public debt, taxation and so on, in each of them; secondly, to follow these phases through the decade, as a whole; and lastly, to form an estimate of the general, prevailing conditions, of the policies pursued and the results which have ensued from them during the ten years under review. Ample material for this study will be found in the annual budget speeches and financial statements of the Finance Members, in the reports of retrenchment and other committees, like the Committee on Taxation, on External Capital and on Railways, in the reports on the management of the currency, the Reviews of the sea-borne trade of India and in the reports of the Currency Commissions and Committees.

4. *Difficulties of the First Period.*—Standing on the borderland between the first and the second of our periods, Sir Basil Blackett summed up the situation as it was in 1924, in the following words, which strikingly bring out the fundamental difference distinguishing those two periods:—"Broadly speaking it may be said that both in the provinces and in the Central Government the era of unbalanced budgets has now been brought to an end. We have got rid of practically all our embarrassments in regard to floating debt and can face the necessity of meeting short-term bonds which mature in the next few years with confidence. There is no longer any fear of our being forced to undesirable expedients such as currency inflation, in order to meet our outgoings. And if the time has not yet come at which we can replace the present statutory, but inoperative ratio, this is due not to our inability to maintain our currency in a sound condition but to a continuance of economic instability in other parts of the world, which makes immediate stabilisation unattractive." Every sentence in the above passage is profoundly significant. It will be inferred from the recital of the above catalogue of achievements, that the chief features which characterised the first period were, (1) unbalanced budgets, (2) embarrassingly large floating debt, (3) undesirable expedients such as currency inflation, and (4) an unstable exchange. Without going into details at this stage, let us try to understand clearly the financial position of the country as it struck the Finance Member himself during the first period and then to ascertain how the miracle, described in the words of Sir Basil Blackett, quoted above, actually happened. It may be stated in general terms that the difficulties of the year 1920-23 were mainly due first, to increased expenditure occasioned by military operations on the Frontier, secondly, to the unfavourable balance of trade and the depres-

sion that had followed in the wake of the boom of the preceding years and prejudicially affected Government revenues, and thirdly, to the failure of the 2*s*. ratio and the consequent necessity to provide for the loss on exchange. Reviewing the situation in his budget speech, in 1922, the Finance Member, having stated that the deficit for 1921-22 would amount to no less than Rs. 34 crores, gave the following further particulars:—"If you carry your minds back to the history of the last three years, the House will realise that this is now the fourth deficit in succession. In 1918-19 it amounted to 6 crores; in 1919-20, mainly due to the Afghan War, the deficit was 24 crores; our final accounts for 1920-21, swollen by many adjustments of arrear expenditure on the Afghan War and the Great War, showed a deficit of 26 crores. Adding the 34 crores to which I have just referred, the total excess of expenditure over revenue in the four years comes to 90 crores." For the year 1922-23, there was an estimated deficit of 31¾ crores, proposed to be reduced to Rs. 25 crores by an increase in the railway passenger fares.

5. *Deficits and Additional Taxation.*—A very important question arose here. Were these deficits, recurring year after year, due to transient causes, so that they might be left uncovered in the hope that before long the revenues would once more equal the expenditure as normal conditions returned? Or was it wise and essential that the annual revenue should be adjusted to annual expenditure by suitable measures of taxation? In answer, the Finance Member stated that it had been the deliberate and consistent policy of the Government of India to meet the expenditure of each year by the revenues of that year and that this rule was departed from only once, so far as he could see, in 1915-16, when Sir William Meyer budgeted for a deficit of about Rs. 4 crores on the plea that the deficiency in the revenue could not be declared to be of a permanent character. In 1922, Sir Malcom Hailey maintained that he could not argue that in the then prevailing conditions, there was any prospect of equilibrium being attained within a measurable period. He was prepared to assume that with the liquidation of frontier commitments, abnormal military charges would disappear and that the revenues would respond to a revival of trade when it came and was ready to take into account the fact that the sabilization of the rupee at 2*s*. would relieve the revenues to the extent of about 15 crores a year—a vain hope as it ultimately turned out. But to him the problem did not appear as one of carrying on till he turned the corner because the turning was nowhere visible. The deficits were being met partly by the issue of unbacked currency notes and partly by the sale of Treasury Bills to the public—not a very advisable method of raising funds in the circumstances. Other methods that would suggest themselves, were calculated to be ineffective, and adequate additional taxation appeared to

be the only course left open, which it was decided to follow. The budget estimates for 1922-23, as finally passed, however, had to leave uncovered a deficit of over 9 crores, and it was estimated early in 1923 that the figure would rise to over 17 crores. All this, be it noted, was in spite of heavy additions to taxation. To complete the narrative, it may be mentioned that the deficit anticipated for 1923-24, of a little over 4 crores, was met by the doubling of the salt duty.

6. *The Miracle of Transformation of Deficits into Surpluses.*—The circumstances and the prospects being as black as they were painted by Sir Malcom Hailey in 1922, how could the finances be so quickly taken from the stormy seas into placid waters by his successor, who, as has been shown above, could declare in 1924 that the era of deficits had been left behind and that the embarrassments in regard to floating debt were over? How had the transformation been suddenly brought about? The key to the solution of the riddle is supplied by a glance at the comparative statistics of foreign trade during the first few years of our decade. Improved trade is a reliable index of economic revival and a fruitful cause of increase in Government revenues. The Finance Member himself gave the following figures in the month of March in 1924 and in 1925:—". . . . it seems likely that there will be in 1923-24 a record surplus of exports over imports. During the first ten months of the financial year, the surplus in the value of exports of merchandise amounts to 103·47 crores as against 62¾ crores in the corresponding period of last year and an adverse balance of 29·60 crores the year before." In 1925 the position was still better, and the exports for the year constituted a record. "The total value of the exports of Indian merchandise for the first ten months of the financial year 1924-25 was 297½ crores, which is over 60 crores in excess of the figure of 1922-23 and 24 crores in excess of that of 1923-24. Imports have advanced similarly, and the balance of trade in merchandise in India's favour up to the end of January, 1925, was 103½ crores. After allowing for a total import of bullion during the first ten months in question of 61½ crores, there remains a net balance of 42 crores in favour of India, as against 63½ crores a year ago."

7. *Trade Revival.*—With the revival of trade and industry and improvement in general economic conditions, the existing sources of revenue became more productive, while, with the disappearance of extraordinary military charges and owing to the cuts made on the recommendation of the Inchcape Committee on retrenchment, expenditure declined, with the result that it became possible for the Government of India to begin the steady remission of provincial contributions and to reduce the salt duty in accordance with the demand of public opinion, very soon after it had been doubled. The transition from the troublous

times of Sir Malcom Hailey's administration to the easy days of Sir Basil Blackett, may be seen reflected in the statistics of foreign trade, of the yield of principal taxes, of the main heads of expenditure and of the total revenue and expenditure of the Central Government. As regards the value of the foreign sea-borne trade of India, we give below quinquennial averages for the pre-war period (years 1909-10 to 1913-14), for the war period (five years 1914-15 to 1918-19) and for the post-war period (five years 1919-20 to 1923-24); and to take the story to its conclusion, the figures for the two recent years, 1929-30 and 1930-31 have been added.

VALUE OF INDIA'S FOREIGN SEA-BORNE TRADE.

(In Crores of Rupees).

	Pre-war average.	War average.	Post-war average	1929-30	1930-31
Imports, including treasure.	198·8	198·3	320·2	277·5	199·9
Exports, including treasure.	232·5	233·1	319·6	324·1	230·5
Total Trade.	431·4	431·4	639·8	601·6	430·4

8. *Transition Illustrated.*—It will be noticed that in spite of reduced volume, the war average is the same as the pre-war average, owing to higher prices prevailing in war time. On account of the revival of trade and removal of restrictions, the post-war average is higher by nearly 48 per cent., and the figure for the year 1930-31, the last year of the decade we are reviewing, goes back to the pre-war level.

The transition from the first to the second of the periods of our review, is brought out in the following comparative figures for revenue and expenditure:—

CERTAIN ITEMS IN THE CENTRAL ACCOUNTS.

(In Crores of Rupees).

	1921-22	1922-23	1923-24	1924-25	1925-26
Total Revenue.	115·2	121·4	133·1	138·0	133·3
Total Expenditure.	142·8	136·4	130·7	132·3	130·0
Surplus (+) Deficit (—)	—27·6	—15·0	+ 2·3	+ 5·6	+ 3·3
Customs Revenue.		41·3	39·6	45·7	47·7
Salt Tax.		6·8	10·0	7·3	6·3
Military Expenditure.		71·0	61·0	59·6	60·3

9. *High Level of Taxation and Reduced Expenditure.*—That the explanation offered above, of the principal cause of the ease with which the transition from the first to the second period of our review, could be accomplished, is correct, is proved by the fact that Sir Basil Blackett himself has expressed the same view of the phenomenon. In his Budget Speech of 1925, he refers to the unhesitating co-operation which the first Assembly gave to the Government in the unpopular task of making heavy additions to taxation in 1921 and 1922 and to the increase in the salt duty in 1923-24 and speaks with satisfaction and pride of the realised surpluses of substantial amounts both in 1923-24 and in 1924-25, the latter having been secured in spite of the reduction of the salt tax to the figure at which it stood before the increase made the year before. Government now felt so certain about a true, recurring surplus having been secured that they decided to go forward with the reduction of the provincial contributions. The Finance Member found himself in the happy but embarrassing position of having, year after year, a surplus to dispose of, and even in 1924-25, he would have preferred giving relief to the Provinces to the restoration of the salt tax to its old level. To whom was the credit mainly due for the fortunate position in which he found himself? His answer is: "For this result we must pay the tribute of thanks which is so justly due to those who went before us. We are now able to appreciate in better perspective the value of the achievements of those who carried the burden in the dark and difficult years immediately succeeding the War. We are reaping to-day some of the fruits of the labours of the first Assembly, of Sir Malcom Hailey, my predecessor in the office of Finance Member, and of the members of the Retrenchment Committee."

10. *Consolidation and Reform.*—This is not the place to appraise the merits of the work of the two Finance Members and to compare the skill with which each handled his job. Our task is the simple one of describing the conditions in which they laboured and the results which rewarded their efforts. It must, nevertheless, be said to the credit of Sir Basil Blackett that though his lot was cast in more propitious times than those of his predecessor, he utilised his opportunities to the best advantage and sought to bring about a number of useful reforms in the administration of Indian finances. The years 1923-28 thus constitute a period of stabilisation, reconstruction and progress as the earlier ones had been a period of depression, deficits and chaos. (1) The separation of railway finance from general national finance, (2) the adoption of the policy of fiscal protection, (3) the consolidation and the improvement of the public debt position and (4) the extinction of the provincial contributions, which had been acting like handicaps on the Governments of the Provinces in the development of nation-building departments, are some of the outstanding achievements of this period.

The Government of India's exchange and currency policy and the size and the method of its military expenditure have been problems of perpetual conflict between the administration and public opinion in this country; and in both these respects, there was keen disappointment and dissatisfaction in the popular mind in this period. The controversy regarding India's monetary standard and the exchange ratio, has fiercely raged throughout the decade, and we do not appear to have reached the end of it even to-day. On the contrary, interest in the question of our monetary system and policy has revived owing to the big constitutional issues which are bound up with it. The same remark has to be made in respect of the problem of a Central Reserve Bank for India, an institution which Sir Basil Blackett, it appears, would have liked to see soon established as a measure essential for the success of the currency system recommended by the Hilton Young Commission and as a fitting crown on the work of his financial administration. The constitutional and the political aspects of the management of national finances on which we have dwelt at some length in the preceding Chapter, acquire special significance in connection with the solution of these problems of such vital importance to the economic development of the country.

11. *Optimism in* 1928.—The Government of India was so overpowered with a sense of responsibility to the Provincial Governments in respect of the latter's contributions to the central exchequer, that they could not think of lightening or equitably distributing the burden of taxation upon the different classes of the community till that obligation had been discharged. The recommendations of the Committee on Taxation whose report was published in 1926, had, therefore, to remain for the time being unnoticed. The remission of provincial contributions did indeed place at the disposal of Governments in the Provinces more funds which they could usefully spend on social and economic development. But it did nothing to improve the system of taxation, as the burden which the general tax-payer had to bear, remained unaffected. This was a task left to be achieved in the third period of our decade in circumstances which, it was fondly believed, would be favourable for the undertaking. Sir Basil Blackett, therefore, closed his stewardship on a note of cheery optimism and wished his successor a good time in reaping a plentiful harvest of prosperity and comfortable progress. "Intrinsically," he observed, "the financial position of the Government of India seems to me to be sound and prosperous." The concluding sentences of his last budget speech, *viz.*, that of 1928, are worth quoting in full as they provide us with suitable jumping off ground for our passage from the second to the last period of the decade of our enquiry:—"From 1929-30 onwards it will be the privilege of this House and of my friend and successor, Sir George Schuster to find no outside claimant to the recurring surpluses which I hope it will be their

good fortune to enjoy in the coming years, and they will be free to turn their minds on the one hand to new directions in which money can be usefully laid out for India's advancement, and on the other hand to the readjustment of the burden of taxation and to those reductions of taxation, so welcome to tax-gatherer and tax-payer alike, which apart from some minor cases and with the one big exception of the Cotton Excise Duty, have been beyond our reach in my term of office. I can not more fittingly close my statement than with the prayer that no storm from without or from within may descend upon India to disturb the bright prospects of financial well-being to which she seems to-day to be justified in looking forward."

12. *The Bright Picture Shows Dark Patches.*—But alas! The vanity of human hopes! In the very next year after the retirement of Sir Basil, the bright picture he had painted of the prospect of financial prosperity, began to show, though faintly at first, some dark patches; and his successor, in presenting his first budget, expressed doubts in relation to the assured character of the normal excess of revenue over expenditure which had been assumed. On a close investigation he came to the conclusion that "the gap left by the remission of provincial contributions," had not been really filled and he was inclined to believe that it would be necessary to impose new taxation to balance the true revenue and expenditure. But he decided to hold his hands at the moment, and to watch developments, in the meanwhile attempting to tackle some of the smaller but, in their own way, important questions relating to public debt. The two years 1928-30 were comparatively speaking, uneventful. Signs of coming trouble were, however, visible; and the rumblings of the impending storm could not be mistaken. What a financial administrator likes above everything else, is a calm political and economic atmosphere in and outside the country, so that he may have a chance to employ his skill of management with advantage. In the beginning of 1931, it was felt that the reaction of political discontent in the country on business conditions was, to some extent, an established reality. World conditions were no less unfavourable and discouraging. While expenditure on useful objects like the banking and labour enquiries and agricultural research had to be provided for, there was deterioration instead of increase on the side of revenue. To make good the anticipated deficit, it was proposed to raise the revenue duty of 11 per cent. on the imports of cotton piece-goods to 15 per cent. and to levy an additional 5 per cent. as a measure of protection, against all cotton piece goods from outside the United Kingdom. An increase in the duty on the import of sugar was also proposed, and the rates of the income-tax and the super-tax were likewise raised. An import duty on silver, of 4 annas an ounce, completed the tale of new taxation. No comment on these proposals is here necessary as we are concerned at this stage only to

give a general idea of the development of the financial situation during the concluding part of the decade which is the subject of our enquiry.

13. *Gloomy Out-look.*—It is interesting to notice that in spite of the signs of the times and the additional burden of taxation which had been imposed, the Finance Member was not inclined to believe that this state of things was anything but a passing phase which had its origin in the disturbed world conditions. "There is reason to hope," he remarked, "therefore, that a recovery from the present economic depression will not long be delayed." He defended the policy of seeking to raise more money than appeared to be immediately needed for actual outgoings, on the ground of the paramount importance of creating reserves at a critical juncture in the country's history, and secondly, for preparing the way for a more generous allocation to the Provinces, of sources of revenue for nation-building services. This refers particularly to the silver duty which, it was stated, was a measure chiefly intended to serve as a margin of revenue from which a distribution could be made among the Provinces of funds so badly needed by them for nation-building services. Who would have thought after such declarations and protestations that the immediate financial prospect, though not quite satisfactory, was bad, that Government would be driven, in the short space of twelve months, to take a very gloomy view of the whole situation, that there would be a deficit of over 13 crores according to the revised estimates for 1930-31, that a wider gap between revenue and expenditure would be apprehended for the succeeding year and that additions would again have to be made to the existing burden of taxation? The total yield for 1931-32 of the proposed changes in customs duties and taxes on income was calculated to amount to nearly 15 crores. If this estimate was upset by internal disturbances, interim measures were to be taken to counteract the threatened deterioration. Political and economic conditions have since continued in a seriously disturbed state, to the grave detriment of the finances of the country; and the Government has been confronted with one of the most critical situations it has had to face for years together.

14. *Official view of the Crisis.*—Comparing the close with the beginning of our decade, we showed, in the last chapter, how the finances of India found themselves in an acute crisis at both the ends, and traced the course of intervening fluctuations—the transition of the earlier years of deficits and depression to the conditions of equilibrium during the second period and the reversion of the latter to a critical state. It is futile to attempt a prophecy as to how things are likely ultimately to shape themselves during the third period as the fate of national finances largely hangs on political events and economic developments in the outside world as well as in India. Nor can the limits appropriate to a systematic treatment of the subject under discussion, permit deal-

ing with the passing events of the hour and prying into a near future so full of uncertainties and possiblities. Nevertheless, it is worth while asking and attempting to answer the question whether the prevailing disequilibrium is the usual depression phase of an ordinary "trade cycle," which may be expected soon to pass away and give place, in due time, to a revival or whether it is an unusual phenomenon occasioned by extraordinary causes of a fundamental nature and promising to run an unprecedented course unless comprehensive, concerted and courageous measures are taken by all concerned to direct that course into proper channels and each nation adopts policies suited to the requirements of the changed conditions. It may be recalled that we have referred in this and also in the last Chapter to the different views which three Indian Finance Members have taken relating to the crisis through which the whole of the past decade has passed. In the beginning of our first period it was thought that there were few chances of improvement in the situation in India to be expected within a measurable span of time. Thanks, however, to the effects of additional taxation, increase in public debt, a revival of trade and somewhat drastic retrenchment, there was a quick transformation of the scene, and the country appeared to have entered upon an era of equilibrium, progress and prosperity. Then once more came a depression which, it was believed at the time, would pass away when it had run its brief natural course, but which persists in an uncanny way at the present day. One obvious explanation of this last phenomenon, which lies on the surface, would be the political upheaval India has experienced during the past two or three years as well as a sudden and enormous fall in world prices. No one can deny that national finances cannot remain stable (and that much less can they thrive) in the midst of internal political discontent, distrust and disharmony, which only aggravate the prejudicial effects of a grave economic and political disequilibrium in the outside world. And apart from this political obstacle, it is not surprising that those in charge of the management of India's finances should have, from time to time, taken what would strike a student of the whole problem as restricted departmental and official views of the situation as they found it at the moment. One traces in their pronouncements a tinge either of complacency or of desparation born of the consciousness of non-responsible authority, lacking the support of public opinion. The Finance Member declared in his budget speech of 1931, for instance:—"My main preoccupation is to run the business well while I am responsible for it and to hand it over in sound condition with no hidden weaknesses and with credit unimpaired." This does not mean that the financial administrators ignore the constructive side of the technique of their work. Only, comprehensive and far-sighted views and courageous national policies are denied to them. To a dispassionate and close student of world conditions in general and of India's finances in particular, who has to take longer and broader veiws and to dip below the surface of things, the whole phenomenon may appear in another light. Without concerning himself with passing events and with particular activities of Government and political parties, which, after all, have a transient interest, he must envisage the position as a whole and put it in a proper perspective.

15. *The True Significance of the Crisis.*—An enquiry made on this principle, would lead one to believe that the sight of occasional ebb and flow or of a movement of a cyclic order in economic life in India as well as in the world outside, during the past twelve years, has been more or less of a deceptive character. We must guard ourselves against being misunderstood on this point. An ebb and flow movement in the currents of delicately interwoven relations of modern economic life is undeniable; and it is a matter of practical experience that the power of recuperation inherent in the body economic, is capable of restoring to it the health lost by deterioration occurring in it from time to time. We have also observed already that wavelike movements did show themselves in the flow of financial and economic developments in India during the decade under review. But the important question for consideration here is whether these quick movements can adequately account for the phenomena we are engaged in examining and whether there is nothing more enduring behind them. The condition of world economy has been, in recent years, like the state of the health of a patient suffering from some serious chronic disease and also subject to the frequent attacks of minor complaints like cold. In this case, attention is apt to be diverted from the major and permanent trouble to the petty ailments which keep on coming and going. The occasional succession of calm and ripples on the surface of economic life is sure to create in one's mind the impression that these are the only important natural phenomena worth attending to, which follow each other in a regular order like the seasons of the year and that there is nothing unusual or abnormal happening behind or below them. It is, therefore, necessary to emphasise that the trade fluctuations and other changes which have taken place in the course of the last decade, have occurred against the background of more profound, if less perceptible, movements in the internal relations of the economy of the world. These latter may not attract public attention which is diverted to superficial and dramatic changes like a panic on the stock exchange and the failure of a big banking concern. It is superfluous to point out that the structural or organic changes exercise a silent but more durable influence on economic affairs without a clear understanding of which our judgment about the solution of problems that confront us, from time to time, may prove to be onesided and faulty. National, like individual life indeed needs

day-to-day adjustments to the difficulties and wants as they arise; but this will be mere hand-to-mouth living if it is not animated with a foresight in respect of coming requirements and a true insight into the meaning of surrounding conditions which have a more or less permanent influence upon it. It will, therefore, be readily conceded that the financial management of the Government of India has to be studied not as if it is carried on only with reference to the difficulties and the expedients of the hour, but in view of the larger constitutional, cultural and economic changes taking place around us if the administration of affairs is expected to be conducive to the progressive well-being of the people.

16. *Structural Changes in World Economy and Prevailing Crisis.*—It will not be inappropriate here to state that a careful examination of the conditions of the world crisis, of which the Indian problem is only a part or a phase, undertaken in connection with the Sir William Meyer lectures delivered at the University of Madras, about this time last year, on the subject of the "Problems of World Economy," led us to accept the conclusion of some of the German thinkers who have made special studies in this domain, *viz.*, that the prevailing world maladjustment is an outward expression of the radical structural changes in economic organisation which have been caused by the great war and the territorial and political adjustments made at the peace which closed it. The Peace of Versailles had an unsettling effect of an unparalleled character on the economic and the political organisation of the world, the profoundness and the dimensions of which were not foreseen at the time, though attention was drawn to the subject by a few critical observers like Prof. Keynes. It cut up old nations and created and guaranteed the independent existence of new ones and prescribed huge reparations payments by Germany to the conquerors. As a consequence of this, the old economic equilibrium of Europe and of the world, was rudely disturbed, tariff barriers, newly set up on national frontiers, impeded trade every where and markets and exchanges were seriously dislocated. Power of consumption of the mass of the people was unequal to the increased productive capacity of industries, improved by rationalisation; distressing unemployment spread widely and the burden of taxation became heavy. The old "division of labour" among the nations of the world was altered in practice as well as in principle; and local and national tendencies towards self-reliance and self-sufficiency in the supply and consumption of necessaries, comforts and luxuries, began to be strengthened. In the intensified international struggle for existence which ensued, peoples were impelled by the motive of self-protection and self-preservation, to resort to measures of a restrictive character which, having been the effect of the world's economic disequilibrium, have been the cause of further maladjustment.

17. *Universal Remedy sought for Universal Trouble.*—The universal disease, it was thought, obviously needed a universal remedy, as the disturbance of the established economic relations between nations could be cured only by international co-operation. The international conference at Genoa which suggested to the nations the desirability of the balancing of their budgets as a step towards currency stabilisation, the World Economic Conference of Geneva, of 1927, which recommended the lowering of tariff barriers as an effective remedy for the trade and industrial depression, the famous Disarmament Conferences and the joint efforts now being made to lighten the burden of Germany's reparations payments, indicate how the ideas of businessmen and statesmen have been moving in the direction of international, concerted action to bring about an economic revival. The mal-distribution of gold in the world, the consequent low level of prices and prevalence of unemployment and industrial stagnation, are all found to cry for international co-operation in the work of rehabilitation. While the efficacy of the remedy is duly recognised, nations, however, find themselves in such a position that they have first to attend to their special domestic conditions and problems and can think of international action only in so far as it is felt to be compatible with efforts to overcome their own internal difficulties. National hopes and fears have been roused as a consequence of the great war, and the changed economic and political conditions act and re-act upon one another. It would be an unwarranted optimism, it seems to us, for nations to aspire automatically to attain the pre-war economic equilibrium and prosperity in the altered circumstances, and they will have to make the most of the situation in which they find themselves.

18. *Lesson for India.*—India's financial problem will obviously have to be discussed and solved in the light of these world movements; and this country cannot escape the influences which are at work outside. Great Britain, which has practised and preached free trade for generations, and has advocated it as an effective remedy for the world's economic ills, even in recent international conferences, has had to abandon that policy as a measure of self-protection. The ups and downs in India's financial history during the past decade, represent the country's re-action to the time spirit, to the constitutional, social and economic ideals which have swayed the peoples of western and eastern countries since the war, as well as to the changes in prices, markets and in demand for commodities. Financial stabilisation and improvement can come only with the practical recognition of the facts and considerations pointed out above. Patchwork methods have indeed to be adopted at times, and they have their use as temporary expedients. They can, however, yield no abiding results, which can be achieved

only by a realisation of the significance of the profound changes occurring inside and outside the country.

19. *Lines of Enquiry conducted in following Chapters Indicated.*—The lines on which our enquiry will be conducted in the following chapters, may now be briefly indicated. We shall take up, one after another, the three periods into which the decade under review has been divided, and the developments in each will be closely scrutinised under different headings. Thus exchange and currency, central revenue and expenditure, deficits and surpluses, taxation and public debt and capital outlay and railway management will be separately studied in each period. The conditions, in which the passage of one period into another was effected, will be described in appropriate places and their relation towards the general world situation will be pointed out. The threads of the varied developments in the three periods will be collected from stage to stage so as to present a connected view of the position in different spheres of financial management, and lastly, a general review of the events and the tendencies of the whole decade will be taken. The financial policy of Government in circumstances prevailing at each stage of development will be commented on, and an attempt will be made to indicate the lessons which the survey of the decade is calculated to teach as guides for the present and the near future. In the midst of prevailing uncertainties it will indeed not be possible to chalk out definite lines of financial policy, but it will be extremely useful to be closely acquainted with fiundamental facts and principles in the light of which the national system of finance may be directed and schemes of improvement may be formulated.

CHAPTER III

THE FIRST PERIOD—DEPRESSION, DEFICITS AND DEAD-WEIGHT DEBT

A

Exchange and Currency.

1. *India's War Services and Help to Great Britain.*—It was not possible that our system of currency and exchange should have emerged unscathed from the terrible storm that overtook the financial and economic conditions in India during the first period of our decade. Were it not for the tragic events with which it is filled, the story of the vicissitudes of Indian exchange and currency in the course of these years, would read like a romance. In order to be able to appreciate the gravity of the crisis and its far-reaching consequences, it is necessary to begin the narrative two years before the opening of the decade. It should be noted here that the financial embarrassment of India during the War and the post-war era, were largely due to the active participation of this country in the prosecution of the struggle and the willing and unstinted assistance which it rendered to Great Britain in bringing it to a successful termination. One of the ways in which this assistance was effectively rendered was the adoption of a system under which the disbursements for war purposes made by the Government of India, in this country, on behalf of His Majesty's Government, were met by the latter by repayment in London without provision being made for the remittance of those funds to India. Our resources thus got transferred to England on a very large scale, to the embarrassment of the Indian Treasury. After setting off against the repayments, the funds required for expenditure in London for "home charges" and the purchase of silver for the coinage of rupees in Indian mints, the Secretary of State for India found that large balances accumulated to his credit on that side. How to transfer these accumulated funds back to India to enable further outlay being made and the balance of trade being liquidated, was a problem of the severest difficulty that taxed official brains. There were limits to the imports of silver which had already assumed huge proportions; and gold could neither be imported nor earmarked in London against the concurrent issue of notes from the Paper Currency Reserve in India, in the interest of the Empire. How to get out of the impasse, was the problem to be faced.

2. *Indian Funds Locked up in London.*—The situation was met by the investment of a portion of our Currency Reserve in British Treasury Bills instead of being held in the shape of ear-marked gold; that is to say, these funds were lent to the British Government, for the time being, just as the United States granted loans to the Allies to cover the larger portion of their disbursements in America. A part of the repayment was also written off as a war gift to Great Britain to the extent of the proceeds of War Loan raised in India. This amounted to a dead-weight debt incurred by the Government of India to meet a part of its war contribution while it made funds available for financing war disbursements here. Some idea of the hugeness of the size of these transactions may be conveyed, if it is stated that war expenditure for His Majesty's Government and analogous items, involved India in a net outlay, in this country, of £128 million during the first three and a half years of the war, and in addition to this, about £30 million a year on an average, had to be provided for Council drawings to meet the internal demand of trade for fresh funds. It was estimated that our investments in British Treasury Bills would amount, by April, 1918, to £67 million. It will be seen from these figures that the main difficulty encountered was how to convert the credit obtained from the British Government in London for outlay on their behalf in this country, into remittances which would release funds essential for use in India. The situation was summed up in the Finance Member's speech in 1919, in the following words:—"Gold was unobtainable and silver was scarce. Thus the repayments of our war advances continued to bank up in London and were of little help in meeting our expenditure here. Currency had to be created and currency could take only three forms, notes, rupees or gold. To issue notes freely without a strong metallic backing was obviously unsound. To coin and issue our relatively small stock of gold would have been wasteful to a degree; the premium upon the metal would have driven and did in fact drive, any coined gold out of circulation immediately; it was an emergency ration than a currency medium. We had no alternative but to provide silver rupees in immense quantity; and this was the second aspect of the problem."

3. *Short Currency Supply—Silver Scarce and Dear.*—The prevailing high prices required a larger supply of currency to the public. The supply of gold and gold coins being ruled out, the demand could be met only by the issue of notes and rupees. The active note circulation had already gone up from 50 to 82 crores of rupees since the beginning of the War, and its further expansion was limited by people's willingness to use paper money and Government's capacity to encash the notes when presented. Owing to fierce competition in the world, even silver was not available in sufficient quantities, and the price of the white metal rose steadily to unprecedented heights, threatening the stability of

the Indian exchange. The position in the early months of 1918 was critical and Government's stock of rupees had sunk in June to the perilous level of 4 crores. It appeared as if there was nothing for it but to declare the paper currency inconvertible. Government escaped by the skin of its teeth from this catastrophe as a result of the release by the United States of 200 millon ounces of silver for India's use under the famous Pittman Act and the feverish activity of our Mints in turning that metal into enormous masses of rupees. The output attained, during the month of December, the colossal figure of 834 lakhs of rupees, which created a world's record and together with the concurrent outturn of small pieces, amounted to over one hundred million pieces. To safeguard the currency system against the possibilities of a collapse, restrictions of various kinds had been imposed on the movement of specie and to some extent on the free encashment of notes, whose net circulation by March, 1919, had risen to Rs. 150 crores. Export finance was similarly controlled, and the co-operation of Exchange Banks and merchants was secured in supplying successfully the finance needed for the export of the necessaries of war.

4. *The Dearer the Silver, the higher was the Exchange Ratio put up.*—Reference has already been made to the high prices and the scarcity of silver and to the extreme difficulty experienced in the issue of rupee currency in India. This development had an important bearing upon the Indian exchange. The pre-war level of the price of silver was in the neighbourhood of 26*d.* per ounce. From 1916, it steadily rose and along with it, rose the rate of exchange, the two being quoted at 42*d.* per ounce and 1*s.* 5*d.* respectively in the beginning of 1918. To prevent the rupee from going into the melting pot or being smuggled abroad, it was necessary to put up the rate of exchange to 1*s.* 6*d.* for the sale of "council" drafts. This rate continued throughout the year 1918, and when it sagged for a few months, "reverse councils" were sold to the public to the amount of £3½ million. It is interesting to note in this connection that the fact that the accounts of the Government of India were maintained on the basis of a cerain ratio of exchange and that the actual rate of exchange at which remittances were effected in the course of a year, introduced into those accounts the heads of 'gain and loss on exchange', corresponding to the difference between the two rates. The net profit thus accruing, after the loss due to the coinage of rupees had been allowed for, was estimated for the year 1918-19 at £4·3 million and it was hoped at one time that the first instalment on Government's new war liability might be met in full out of a surplus accruing largely from this windfall. Another aspect of this subject that may be referred to here, relates to the funds Government had been borrowing, in its difficulties, from the Paper Currency Reserve on the security of its own promises to pay. The Finance Member admitted in 1919

that Government's resort to the printing press and purchase of their own Treasury Bills as a method of obtaining funds must not be used except in emergency and with the greatest caution. He was anxious to retire at least that portion of paper which was represented by Government Treasury Bills, though he felt it was difficult to go further and reduce the outstanding note circulation so as to put a stop to the prevailing discount on paper currency in the countryside. The experience of the next twelve months did not, however, lead Government to feel it safe to return to the free and unrestricted issue of rupees at district treasuries throughout the country though stocks of silver coin were now far from meagre. The year 1919-20 was a time of a boom; prices ruled high and both imports and exports showed increases. It was a particularly remarkable year in the history of Indian exchange, though it was comparatively uneventful regarding currency affairs.

5. *The 2s. Rupee-Gold Ratio.*—In his budget speech in 1920, the Finance Member went so far as to remark that the events of 1919-20 relating to our exchange formed a landmark in the history of that interesting subject, and his words are worth quoting here:—"The history of Indian exchange and the establishment of the gold exchange standard, subsequent to the closing of the mints, has always had a fascination for economic writers and students. It seems likely that when future text books are written or present ones are brought up to date, the year 1919 will, like 1893, stand out as marking the close of one well-defined period and the commencement of another." This appreciation of the situation, we are afraid, has not been justified by events, and it has, in fact, turned out to be colossal exaggeration. On the contrary, Government's policy in respect of the exchange during 1919-20 and 1920-21 has won an unenviable fame for its costly mistake and for its disastrous perseverance in a wrong course of action. Let us now see how things actually shaped themselves. The sterling-dollar exchange having been unpegged early in 1919, the British pound lost the support it had received as a war measure, and steadily depreciated, till it sank to the low level at which it stood in February, 1932, say, 4·3 dollars to the pound sterling. Owing to a combination of circumstances, of which this was an important factor, the price of silver shot up to 130 cents per dollar, and the Indian exchange had to be pushed up, in sympathy with sterling, to 2*s.* 4*d.*, by December, 1919. Uncertainty about the prospect led to fluctuations in the exchange, and demand for remittance to and from India rose and fell in succession. Then came the Babington Smith Committee's report and the Secretary of State's announcement of acceptance of its principal recommendations. These related to the linking of the rupee to gold instead of to sterling and to the adoption of the 2*s.* ratio. As to the first of these measures, its theoretical importance is undeniable and has scarcely been denied; but the his-

tory of Indian exchange and currency has demonstrated the practical unreliability of the paper fixation of the rupee in terms of gold. There was really nothing new in this in as much as since the adoption of the gold standard by India, the legal unit of value was a fixed quantity of the yellow metal, and the only Indian member of the Babington Smith Committee strongly protested against a change in this unit by mere executive action. Our experience of the events of the past few months is calculated to confirm the truth of this statement. The 2*s*. ratio was defended on the ground that through it, internal prices would be lowered, to the immense benefit of the large mass of poor Indian consumers who were restive under the pressure of the extreme dearness of commodities that prevailed and that it would ensure the rupee against its going to the melting pot as it would stand far above the melting point of the silver currency of almost every other country.

6. *Collapse of the High Exchange.*—Though the rupee was linked to gold, with the further depreciation of sterling, Indian money was worth more in terms of pence, and this proved a great incentive to people to remit funds abroad. Government, which had undertaken responsibility for maintaining the rupee at the newly chosen level, had to sell reverse councils in large amounts to satisfy the unprecedented demand that arose for remittance; £.11 million sold during February, 1920, was insufficient to meet the public demand; speculators and profiteers came into the field; and a wide divergence arose between the gold rate at which reverse councils were being sold and the actual market rate. The sterling resources of Government were certainly not inexhaustible, and the loss accruing from the revaluation of gold and sterling portions of India's reserves on the basis of the new ratio, was not inconsiderable. During the twelve months, March 1920 to March 1921, the story of Indian exchange took a dramatic turn. The balance of trade which had been largely in favour of India, suddenly became adverse and materially added to the strain on Government's capacity to prop up the exchange. When Indian currency seeking conversion into foreign money, exceeds the supply of the latter, (and this was the result of the adverse trade balance), the value of the former expressed in terms of gold or international currency, must decline. Thus, in twelve months, the exchange rate in the market had come down from 2*s*. 7*d*. to 1*s*. 4*d*. Government's persistent sales of Reverse Councils in spite of the heavy losses entailed and the ultimate failure of their declared policy, were subjected to severe criticism. Their only defence was that the circumstances in which they had to work were beyond their control, since they had undergone a sudden and unexpected change. There was, however, little that was reasonable, to urge in support of the persistence with which the ruinous course of attempting the impossible, was pursued, and Indian resources in London were frittered away, particularly in view of the fact that the gap to be covered was too wide and that

Government's policy stimulated speculation and aggravated the difficulties of the situation. In September, 1920, all attempt to support exchange was given up and the rupee was left to itself till at last it sank to 1*s*. 4*d*. and Government frankly confessed that they had now no definite exchange policy and contemplated no measures in relation to the prevailing trade depression and the general feeling of uncertainty existing.

7. *"Wait and See" Attitude of Government to the Exchange Question.*—When it was asked to explain "how far the persistence in the selling of Reverse Councils on the system first adopted was due to our (Government of India's) deliberate choice or how far the responsibility lay with the Home authorities," particular emphasis being laid on the failure to adopt the system of sale by competitive tender, the reply of Government was, in the words of Sir Malcom Hailey:—"I regret that it is not within the power of Government to answer these enquiries." This was, at best, enigmatic and could be interpreted according to one's inclinations. There is no doubt, however, that the Government of India came later to wish that this chapter in the history of Indian currency and exchange had not been written. "Once bitten, twice shy", sums up henceforward its attitude to this question till after the recommendations of the Hilton Young Commission were adopted. In 1923, the prospects were still uncertain, and Sir Basil Blackett held that the time had not yet arrived when another effort should be made to stabilise the rupee at a particular level. He expressed the opinion that the attempt of 1920 was an almost impossible one, "with all exchanges of the world out of gear, with world prices moving up and then down with unexampled rapidity, and with relative prices as between one commodity and another fluctuating in an unheard of manner." And world conditions in 1923-24 were not much better to warrant the statutory fixation of the rupee at any particular level. In view of the line of thought taken on this question by the Government of India four years later, it would be worthwhile noticing what Sir Basil had to say in his very first budget speech, in this connection. His views may be briefly summarised thus:—There is no sanctity about any particular ratio of exchange; it is a question of what suits India's needs best. To look at it from a narrow point of view of the Indian budget, Government would have a smaller sterling debt at a higher rate than at 1*s*. 4*d*. and it would save a few crores on its remittances. Although the tendency of the rupee to follow world prices rather slowly had, since 1920, ceased largely to operate, it could not be maintained that internal prices in India had adjusted themselves to a level corresponding to a 1*s*. 4*d*. exchange so that if the exchange were stabilised in 1923 at 1*s*. 4*d*., prices would have to go up. On the other hand, an attempt to force up exchange violently, would cause stringency, which was undesirable from the point of view of everybody. Any policy, again, which threatens to restrict India's export trade,

must also be deprecated; "and, trade, above all, desires stability of exchange, perhaps even more than stability of prices. . . . Stability is our goal and we mean to achieve it at the first opportunity."

8. *Exchange and Currency.*—The chief features of exchange and currency developments during the first period of our enquiry that deserve special notice, are (1) the price of silver, (2) the prevailing and the statutory rates of exchange, (3) the annual balance of trade and Government remittances to London, (4) currency circulation, and (5) the composition of the Paper Currency Reserve. With regard to silver, the price of that metal was, for some time now, the dominating factor in the exchange situation in India, and it determined the external as well as the internal value of the rupee. Before our mints were closed to the coinage of rupees in 1893, the steady fall in silver prices, spread over a number of years, brought about a corresponding fall in the Indian exchange. This close association between the price of silver and the rate of Indian exchange, was destroyed by the degradation of the rupee to the status of a token coin and the legal stabilisation of its external value at 16*d*. The association was re-established when Government was compelled, in War time, to coin large quantities of rupees and the price of silver rose so high that the bullion value of the rupee exceeded its legal or nominal value. The latter had, therefore, to be raised from time to time in accordance with the rise in the price of silver to save the coins, put into circulation, from being used as bullion. Even then the market rates varied from those fixed by Government, owing to the latter's inability to control them through the usual means. Before 1893, the change in the price of silver and, therefore, in the exchange ratio, was slow and steady. During the war period and after it, the change was sharp and lasted but for a short time. In February, 1920, the price of silver had reached the record figure of 89½*d*. an ounce, in April, it slided to 72*d*., and it gradually declined till it went down to 30*d*. in March, 1921. For months, the movements of silver prices and of the rupee-sterling exchange were almost parallel. Exchange stood at 2*s*. 4*d*. in April 1920, sank to 1*s*. 10*d*. in August, to 1*s*. 6*d*. in December and dropped to 1*s*. 3d. in March, 1921. The following table illustrates the parallelism in an interesting manner:—

MARKET RATES OF EXCHANGE AND BULLION VALUE OF THE RUPEE.

	1918—1919		1919—20		1920—21	
	Rate of Exchange T. T.s	Bullion value of rupee	Rate of Exchange T. T.s	Bullion value of rupee	Rate of Exchange	Bullion value of rupee
	pence	pence	pence	pence	pence	pence
1st April ..	16·9	16·9	17·9	18·4	28·0	26·8
1st August ..	17·9	18·1	19·9	20·7	22·6	21·1
1st November ..	17·9	18·3	24·2	24·3	19·3	19·6
1st January ..	17·9	18·0	27·8	28·1	17·2	15·5
1st March ..	17·9	17·7	31·0	31·2	15·3	12·0
15th March ..	17·9	17·7	27·7	26·1	15·5	12·4

9. *Price of Silver and Gold Exports as Controlling Factors in Exchange Ratio.*—It is worth noticing that the parallelism between the rate of exchange and the price of silver was broken during the last few months of 1920-21, and the exchange value of the rupee remained at 2*d*. or more above its bullion value. This is accounted for by the fact that in these months, there was export of gold on a large scale, which propped up the exchange and prevented it from falling in sympathy with the price of silver. The general principle underlying this phenomenon was neatly put in an Appendix to Mr. H. F. Howard's Currency Report for 1913-14 and was aptly quoted in the Currency Report for 1920-21. The following is the quotation referred to:—"There remained, however, the danger that in particular years when India's debits exceed her credits, a depreciation in the value of the rupee would still occur unless measures were taken to prevent this. For if she owes more abroad than foreign nations owe to her, it is clear that her claims on foreign debtors in the shape of foreign bills of exchange will be relatively scarce; thus those wishing to remit money to London would have to pay a larger number of rupees for bills on London for a specified number of sovereigns. In other words exchange would fall to the point at which it would be more profitable to send gold than to remit by means of bills. In practice, no gold might be available for export at such a time, and in such a contingency the rupee might, in the absence of proper safeguards, fall till it was worth no more than its bullion value at the rate of the day." During the second half of 1920-21, the export of gold amounted to Rs. 21 crores as compared with about 6 crores of

imports. The corresponding figures for the first half of the year were 35 lakhs and 17 crores respectively. The total value of gold imported in the whole of that year was Rs. 23½ crores. This was less than one half of the amount imported in the preceding year and it has been exceeded on seven occasions since 1900. The exports of gold, however, in that year, which amounted to Rs. 21½ crores, were phenomenal, being far in excess of any previous year. These happenings have a special interest at the present moment when India has exported over 50 crores worth of gold in the course of the past six months. The following comment of the Controller of the Currency on the above gold exports, is worth recalling here:—"In view of the charge commonly made that India is a 'sink of the precious metals' her ability to export gold is not without significance."

10. *Balance of Trade and Exchange.*—Having decided to make the 2*s*. gold ratio effective, Government continued, in 1920-21, the sale of gold to the public, commenced in the previous year, with the double object of removing the prevailing premium on that metal and of supporting the sagging exchange. Not less than 12½ million tolas of gold were sold in the year 1920-21, and the importance of the bullion market in Bombay was shown by the fact that out of this amount, nearly 10 million tolas were absorbed there. It should be added that "a large proportion of the gold sold by Government was resold later for export at greatly enhanced prices and served as a support to exchange". The figures for exports and imports of gold given in the preceding paragraph should be recalled in this connection. When the first Government sale of gold took place in September, 1919, the price of country bar gold was over 32 rupees per tola. Continued sales for twelve months brought it down to Rs. 24 and with the cessation of the sales, it once more rose till at last it shot up to Rs. 30 per tola, in March, 1921. Sale of 'reverse councils' had been undertaken in January, 1920, in support of exchange and was continued till the end of September, with the result that £55 million had been transferred to London and the note circulation was reduced from Rs. 185 crores to Rs. 158 crores. But it was all of no avail. Indian funds, accumulated in London, were exhausted, and heavy loss was sustained on the remittance and on the other measures taken to make an impossible exchange ratio effective. After the exchange was left to itself, conditions steadied down gradually in the course of 1922-23 and 1923-24, and improvement in trade and industry was largely responsible for this result. The following figures for the balance of trade will illustrate this change:—

BALANCE OF TRADE.

(In Crores of Rupees.)

Average of 5 years ending

	1918—19	1919—20	1920—21	1921—22	1922—23	1923—24
Balance of trade in merchandise (Private) ..	+76·3	+125·9	—77·5	—20·9	+90·0	144·6
Balance of transactions in treasure (Private) ..	—10·8	—10·8	+1·2	—12·1	—60·2	—48·6
Total visible balance of trade ..	65·5	115·1	76·2	33·0	29·7	96·9
Remittance through councils &c..	—34·0	—36·8	..	..	—7·0	—33·8
Sale of Reverse Councils ..	+5·5	+18·5	+28·5	..	..	..
Balance of remittance of funds ..	—30·1	—19·8	+27·7	+1·2	—6·9	—34·1

11. *Gold Movements.*—The change from the boom to depression, from heavy excess imports to large net exports of merchandise, from record export of gold to a heavy import of that metal, reflected in the above statistics, signifies a decided tendency toward stabilisation of economic and financial conditions. The imports of gold in 1922-23 and in 1923-24 were valued at Rs. 41·3 and Rs. 29·2 crores respectively, while the exports of that metal in both years were almost negligible. The imports of silver in the three years ending in 1923-24 were valued at Rs. 17·4, 20·9 and 22·1 crores respectively. Having dropped to as low a level as 13*d.* in 1920-21, exchange was, later on, steady in the neighbourhood of 16*d.* The huge imports of the precious metals in 1922-23 were attributed to agricultural prosperity, especially in the cotton growing areas where the crops were good and fetched high prices, a feeling of insecurity due to the non-co-operation movement, restricted purchase of piecegoods owing to high prices and the comparative cheapness of gold, the price per tola in Bombay having fallen from Rs. 28-13 on 1st April, 1922, to Rs. 25-2 on 31st March, 1923. During the year 1923-24, prices of cotton were abnormally high while purchases of piece goods were restricted owing to unattractive prices. The price of gold rose to Rs. 26-6 in the course of the year and put a check on its imports, which amounted in value to Rs. 29·2 crores. The Controller of Currency draws from the facts stated above, the interesting conclusion that "in times of agricultural prosperity while a moderate

rise in prices makes no difference in the capacity of the country to import gold up to normal requirements, cheap prices stimulate its acquisition for hoarding purposes and lead to imports attaining record levels." This observation, considered along with the gold movements at other times, would suggest another generalisation, which has a special bearing on the huge Indian exports of gold in the latter half of 1931-32, and it is this: in times of agricultural depression, not only will the imports and the consumption of gold in the interior of the country, be restricted, but if the crisis is prolonged and becomes severe, gold, known as 'distress gold', in large quantities will come out of the savings of the mass of the rural population and will be exported on an extensive scale, despite the prevalence of political unrest, which would ordinarily encourage the hoarding of the yellow metal.

12. *Absorption of Currency.*—It was to be expected that (1) during the war period, owing mainly to (*i*) prevailing high prices and (*ii*) Government's financial difficulties, there would be a large expansion of metallic and paper currency, (2) when war conditions disappeared and the boom of 1919 was succeeded by depression, currency would return from circulation instead of being 'absorbed' by the public, as in normal times, and (3) as trade and industry revived, currency absorption would start again. The following comparative statistics in this connection, will be found interesting:—

ABSORPTION OF CURRENCY.

(In Crores of Rupees) Return from circulation=(—).

	Rupees.	Notes.	Total.	Sovereigns & half sovereigns.	Grand total.
Total for 5 years 1909-10 to 1913-14	43·8	15·02	58·8	54·5	113·4
Year 1914-15 ..	—6·7	—6·0	—12·7	8·4	—4·2
Total for 5 years 1915-16 to 1919-20.	137·0	109·8	246·0	20·5	267·0
Year 1920-21 ..	—25·6	—5·9	—31·5	—4·3	—35·9
" 1921-22 ..	—10·4	9·3	—1·1	2·7	1·6
" 1922-23 ..	—9·5	3·8	—5·6	9·4	3·7
" 1923-24 ..	7·6	7·9	15·5	6·7	22·3

In war time, owing to high prices and abnormal business activity, currency has to be expanded and there is considerable inflation, large quantities of notes being issued without the usual metallic backing. The story of soaring silver prices and the difficulty of meeting the public demand for rupee currency experienced by Government in 1918, has been already related. It will be seen from the table given above, that while the average annual absorption of rupees and notes in the five years before the outbreak of the War, was Rs. 8·8 and 3 crores respectively, the corresponding figures for the five years, 1915-16 to 1919-20 were Rs. 27·4 and 22 crores. The average gross and active circulation of notes in 1913-14 was Rs. 65·5 and 46·6 crores. In 1916-17, the figures were Rs. 76·1 and 59·3 crores. Next year, the circulation suddenly jumped to Rs. 101 and 71 crores and in 1919-20, the high water mark of Rs. 171·6 and 151·1 was reached. Though the note circulation slightly declined in 1920-21, it has not appreciably receded from the advanced position whch had been reached as a result of war conditions. And the figures for the gross and active note circulation for 1923-24 were the highest on record, being Rs. 179 and 157 crores respectively. The following table will show the whole position at a glance:—

NOTE CIRCULATION.

(In Crores of Rupees.)

Year.	Gross.	Average Circulation (Active).	Increase in Average Active Circulation.
1913-14	65·5	46·6	1·2
1915-16	64·1	48·0	20·6
1916-17	76·1	59·3	11·2
1917-18	101·7	71·8	12·5
1918-19	138·2	113·8	41·9
1919-20	171·6	151·1	37·2
1920-21	163·5	128·8	—12·2
1921-22	173·8	152·2	12·3
1922-23	176·3	153·2	1·0
1923-24	179·0	156·9	3·6

13. *Paper Currency Reserve.*—The familiarity of the public with the use of paper money undoubtedly grew steadily during the war period; and experience showed that the increase in note circulation, which then took place, had come to stay. The expansion of paper currency was rendered possible by the fact that Government adopted the system, to which it was, of course, driven by necessity, of leaving a larger portion of the issue of notes without metallic cover. Power was taken from time to time to increase the invested portion of the

Currency Reserve, to invest a large amount of it in London in British Treasury Bills, and even to hold a substantial part of it in the shape of "created" or "ad hoc" securities, that is, promises issued by Government to pay itself. The latter, which took the form of Treasury Bills of the Government of India, had obviously no market value and were a device intended to help Government with funds which it was difficult to obtain by ordinary borrowing. The following extract from the report of the Controller of Currency for 1923-24 briefly gives a useful account of the origin, form and size of these securities:—"The issue of currency notes against Treasury Bills of the Government of India also commenced in 1918, and reached the maximum of 61¼ crores at the end of 1920-21, which included about 18½ crores of bills issued in consequence of the valuation of 2*s.* per rupee of the gold and sterling holdings in the Paper Currency Reserve in pursuance of the Paper Currency legislation of 1920. The rest of the Treasury Bills were issued to fill a gap in Treasury resources caused by revenue deficits and by the loss on the sales of Reverse Councils. The holding of Treasury Bills in the Reserve was reduced by 3,37 lakhs in 1921-22 and by 8,24 lakhs in 1922-23 by a corresponding cancellation of notes and now stands at 49½ crores". It was only when there was a trade revival and the general financial position of Government improved, that the Paper Currency Reserve could be gradually restored to its normal state. And the Currency Act of 1923 provided for the measures to be taken to this end. It fixed the ratio between notes and the metallic reserve and limited the amount of the holding of *ad hoc* securities. The following table shows the composition of the Reserve before, during and at the close of the first period under review:—

COMPOSITION AND LOCATION OF THE PAPER CURRENCY RESERVE.

(In Crores of Rupees.)

		Coin and Bullion					Securities	
		In India			In England.	In transit.		
Date.	Total Notes in Circulation.	Silver Coin.	Gold coin and Bullion	Silver Bullion	Gold Coin and Bullion	Gold coin and Bullion	Held in India	Held in England
31st March 1920 ..	174·5	33·2	44·3	6·6	..	3·4	19·5	67·2
31st March 1921 ..	166·1	61·4	24·1	4·1	..	..	68·0	8·3
31st March 1922 ..	174·7	72·7	24·3	4·5	..	..	65·0	5·8
31st March 1923 ..	174·7	82·4	24·3	4·5	..	..	57·4	5·8
31st March 1924 ..	185·8	74·1	22·3	5·8	..	..	57·5	13·9

B. DEFICITS, DEBT AND TAXATION.

14. *Revenue and Expenditure.*—Enough has been already said in the course of the first two Chapters to give a fairly clear idea of the general position of the finances of the Government of India; and we may now proceed to invite special attention to its salient features which may be summed up under the following heads:—(1) extraordinary military charges; (2) the prejudicial effect of prevailing economic depression on the revenues; (3) recurring deficits; (4) the imposition of additional taxation; (5) growing public debt, floating and funded; (6) retrenchment and reduction of abnormal expenditure; and (7) the process of recovery. Relevant statistics will provide a telling expression of the acute situation in all the above respects. Let us take, first of all, revenue and expenditure:—

ANNUAL REVENUE AND EXPENDITURE.

(In Crores of Rupees.)

Year.	Revenue.	Expenditure.	Surplus (+) Deficit (—).
1914-15	80·0	81·7	—1·7
1917-18	118·7	106·5	+12·1
1919-20	137·1	160·7	—23·6
1920-21	135·6	161·6	—26·0
1921-22	115·2	142·8	—27·6
1922-23	121·4	136·4	—15·0
1923-24	133·1	130·7	+2·3

These figures are eloquent. In the course of four years, 1920 to 1924, the expenditure, the pre-war figure for which, was only 75 crores, came down from Rs. 160 crores to Rs. 130 crores, while the revenue steadily declined, at the same time, from Rs. 137 crores to 133 crores, in spite of increased taxation; and thus for four successive years there were considerably large deficits. This excess of expenditure over revenue is accounted for in a large measure by the huge military charges that had to be incurred, particularly owing to the Afghan war and the frontier operations, immediately on the termination of the Great War. The following statistics in this connection, will be found instructive:—

MILITARY CHARGES.

(In Crores of Rupees.)

Year.	Gross.	Net.
1914-15	32·7	30·8
1917-18	46·5	44·0
1918-19	70·2	66·7
1919-20	87·2	83·3
1920-21	88·2	81·8
1921-22	77·8	69·8
1922-23	71·0	65·2
1923-24	61·0	56·2

The net military charges, that is, the gross expenditure *minus* receipts, rose from about 31 crores in 1914-15 to over 66 crores in 1918-19. The highest level was reached in 1919-20 and then the figure steadily declined to 56 crores in 1923-24. What wonder that the accounts of Government should show large recurring deficits when the revenues could not be made to keep pace with such unusually large demands on the exchequer? The remedy was to increase the revenues and to reduce the expenditure. Even with the disappearance of the extraordinary charges in military expenditure, the total amount the Government had to find for running the machinery of administration, both military and civil, shows large increases over the pre-war figures and the figures of the war period; and new taxation was resorted to for the purpose of filling the gap. It is necessary to note that the excess of expenditure over revenue which occurred in spite of increased taxation, was defrayed, to a considerable extent, by borrowing through treasury bills, both those issued to the Currency Reserve and those sold to the public, that is, by adding to the floating debt.

15. *"Ways and Means" Position.*—Let us examine the situation as it presented itself early in 1921. According to the Finance Member, the problem was not only to balance the budget at any cost, but to provide adequate resources to meet the commitments of the near future, *e.g.*, remission of provincial contributions and clearing off of losses accruing in remittance transactions which were carried to a suspense head. It was, therefore, proposed that the deficit anticipated for 1921-22, of over 19 crores, should be covered by means of additional taxation of about the same amount; and the general import duty was raised, and

matches, liquor, Railway and postal rates and income-tax, were all subjected to increases. Besides the current revenue and expenditure, it is necessary to emphasise, we have to take account of the "ways and means" position and of the capital expenditure of the Government in order to obtain a full and clear idea of the state of national finances at any given time. There are constant incomings and outgoings of various funds into Government Treasuries, of which the ordinary revenue and expenditure charged to it, form a part. For instance, capital has to be found for the extension of railways, an advance has to be made or a loan has to be granted to a provincial government, a central revenue deficit has to be met and a short term debt has to be paid off. The resources out of which these and similar other outgoings are met, are the various funds which are in deposit with Government, *e.g.*, the balances of the Postal Savings Bank and Cash Certificates, advances taken from the Imperial Bank of India, Treasury Bills sold to the public and short and long-dated loans obtained in the money market here and in London. It has been already pointed out that currency notes issued against Government's own promise to pay, have been frequently used for the same purpose. A comparative statement showing the ways and means operations for India and England together, as they appeared in the revised budget for 1922-23 and the budget for 1923-24, which are given below, will throw instructive light on this question:—

WAYS AND MEANS OPERATIONS.

(In Crores of Rupees.)

Liabilities.	Revised estimate, 1922-23.	Budget, 1923-24.
Railway capital outlay ..	21·4	38·6
Delhi, Irrigation & Telegraph capital outlay ..	3·0	2·9
Discharge of funded debt, &c. ..	12·4	5·2
Discharge of Treasury Bills:—		
With the public ..	32·4	5·5
In the Currency Reserve ..	8·2	..
Loans to Provincial Governments ..	11·4	13·5
Central Government's Revenue Deficit ..	17·3	..
Drawings of Provincial Governments ..	..	1·3
	106·1	67·0

Liabilities.	Revised estimate, 1922-23.	Budget, 1923-24.
Met as follows:—		
Central Government's Revenue Surplus ..	..	·2
Surplus Revenue of Prov. Govts. ..	1·0	..
Rupee Loans ..	46·9	25·0
Sterling Loans (converted at 1*s*. 4*d*.) ..	47·3	22·7
Net Receipts from Savings Banks deposits &c.	3·1	5·0
Miscellaneous Items ..	2·5	2·2
Reduction of Cash Balances ..	5·3	11·9
	106·1	67·0

16. *Capital Expenditure and Increasing Rates of Interest Paid.*— The above table will amply repay a careful examination, inasmuch as it is calculated not ony to illustrate what has been stated above regarding the ways and means operations but to bring out the contrast between the financial position of the year 1922-23 and the situation as it was estimated to be for 1923-24. It needs to be mentioned in this place that funds could hardly be provided during the war period for the extension, repairs and renewals of the Indian railways which, however, continued, for the time being, to yield very good returns. The time had now come, it was thought, when Government had to make up for this neglect, and a special committee presided over by Sir William Ackworth, which had been appointed for the purpose, recommended various measures for their improvement, financial and otherwise. To enable that object being attained, it was decided to provide Rs. 150 crores out of capital in the course of five years. During 1922-23, it was not possible to spend the whole of the 30 crores allotted under the five years programme, and including that balance, it was proposed to provide for capital expenditure on Railways, the total sum of 38·6 crores during the year 1923-24. These figures appear prominently in the above table. In 1922-23, Government reduced the floating debt amounting to over 40 crores, of which 32 crores consisted of a net discharge of treasury bills held by the public and 8 crores of a cancellation of treasury bills held in the Currency Reserve. This was done by converting that species of loan into securities of a longer term. The enormous resources needed to meet outgoings on such a vast scale, consisted of both sterling and rupee loans, each of which yielded about 47 crores in 1922-23. Little could be done in the direction of reduc-

ing floating liabilities in the shape of Treasury Bills during the preceding years so long as deficits persisted and fresh borrowing on a large scale was essential. Government was able to borrow in this country annually amounts, the size of which would have been regarded as impossible in pre-war days, owing mainly to active propaganda and the temporary prosperity which war conditions had brought to a certain class of people. Even then, the money had to be borrowed at steadily rising rates of interest. Before the war, the normal rate was 3½ per cent. Higher rates had to be successively offered, income-tax free; and in 1920-21, as much as 6 per cent. income-tax free had to be offered to attract the investor. The principal securities had, likewise, undergone heavy depreciation. The effect of Government's growing indebtedness is seen clearly reflected in the progressive increase that took place in the annual expenditure on interest, exclusive of what was spent for Railway debt, and it is brought out in the following table:—

INTEREST CHARGES.

(In Crores of Rupees.)

Year.	Charges	Year.	Charges
1917-18 ..	7·3	1920-21 ..	15·2
1918-19 ..	8·1	1921-22 ..	15·9
1919-20 ..	11·5	1922-23 ..	16·1
		1923-24 ..	17·3

17. *Growth of Unproductive Debt.*—The decision to provide for a large outlay of capital on Railways, was, at least in part, due to the general impression in the public mind, which was shared by the Government and the Legislature alike, that the termination of the Great War must inevitably be followed by an era of prosperity, and it so happened, as has been pointed above, that the sums provided for railway capital could not be actually utilised. It was not realised at the time that the capital outlay would take long to bear fruit and that the anticipations about its productivity might not materialise. It was, however, the unproductive debt which had been piled up, that constituted a heavy burden which the tax-payer would find it particularly hard to bear. The following table shows how India's public debt, in its various forms, steadily grew during the ten years after the outbreak of the War:—

INDIA'S PUBLIC DEBT.

(In Crores of Rupees.)

	31st March, 1914.	31st March, 1918.	31st March, 1922.	31st March, 1923.	31st March, 1924.
Funded Debt in India.					
Rupee Loans ..	145·6	201·8	305·1	339·8	358·8
Treasury Bills in the hands of the public ..	..	43·5	53·9	21·5	2·1
Total Funded Debt in India ..	145·6	245·4	359·1	361·4	360·9
In England (at Rs. 15).					
Sterling Loans ..	265·6	259·3	277·3	334·3	366·8
Unpaid balance of India's war contribution ..	..	96·0	30·3	29·5	28·9
Total Funded Debt in England ..	265·6	355·4	307·6	363·9	395·7
Unfunded Debt.					
Post Office Savings Banks ..	23·1	16·5	22·2	23·2	24·7
Post Office Cash Certificates ..	..	8·3	4·3	3·1	8·4
Balance of Provident and allied funds ..	10·9	19·0	32·9	36·2	39·0
Total unfunded Debt ..	34·1	44·5	59·5	62·5	72·2
Capital value of liabilities undergoing redemption by way of terminable Railway annuities..	105·9	100·2	93·7	91·9	90·1
Total Debt ..	551·2	745·6	820·1	879·9	918·9
Distribution—					
Productive Debt —Railways ..	438·6	458·7	519·8	536·4	556·2

	31st March, 1914.	31st March, 1918.	31st March, 1922.	31st March, 1923.	31st March, 1924.
Telegraphs ..	11·3	12·3	15·2	15·8	16·8
Irrigation ..	2·7	3·4	3·5	3·5	3·5
Total Productive Debt ..	452·7	474·5	538·6	556·8	576·6
Unproductive Debt of Central Government ..	26·5	194·0	203·5	236·5	243·5
Incurred on behalf of Provincial Governments ..	71·9	77·0	77·8	87·4	98·8
Total ..	551·2	745·6	820·1	879·9	918·9

If the Indian Treasury Bills of the value of Rs. 49½ crores held in the Paper Currency Reserve are included, the total unproductive Debt of India at the close of the year 1923-24 stood at Rs. 293 crores. Rs. 18½ crores out of this, related to the Treasury Bills issued to the Paper Currency Reserve in connection with the re-valuation of the gold and sterling securities held in the Reserve. "The balance of unproductive debt amounting to Rs. 274½ crores is attributable to (*i*) the war contribution of £100 millions, (*ii*) the revenue deficits of recent years, and (*iii*) the loss to Treasury resources which resulted from the sale of Reverse Councils in 1920." The financial policy of Government during the ten years 1914 to 1924 will be judged in the light, among other important things, of the addition to the unproductive debt of the country, of nearly Rs. 275 crores, which means an average of Rs. 27 crores per year. In this connection the critic will consider Government's management of Indian finances in relation to (*i*) the operation of the system of exchange and currency, (*ii*) the ruinous sale of Reverse Councils, (*iii*) the exhaustion of national assets accumulated in London, (*iv*) the war contribution of £100 million which, along with the proceeds of the Reverse Councils, was utilised to wipe out those assets, (*v*) the increased military expenditure and (*vi*) the resulting heavy addition to the burden of unproductive public debt; and he will form his estimate of the general situation in the light of the combined effect of these factors on the economic and financial condition of the country in the coming years. Before taking leave of this subject, it will be useful if we make a brief reference to the origin and the operation of Government of India's Treasury Bills. This is a method, now in common practice, employed by Government to obtain funds by short-term borrowing from the public to enable them to adjust the incomings to the outgoings in the course of the financial year. Through this form of 'floating debt' Government can, however, not only secure the funds they need for temporary use but can control the money market and the exchange and currency position by means of the influence the dimensions of the operations can exercise on loanable capital and monetary circulation. Sale of Treasury Bills to the public as a method of Government borrowing, was started as an experiment in 1918, and it has come to stay. In his budget speech in that year, Sir William Meyer observed as follows on the subject:—"The drain on our resources caused by heavy war payments for His Majesty's Government and the Secretary of State's Council Bills led us, in the middle of October, to introduce a new experiment—the issue of short-term Treasury Bills, which could be taken at option for periods of 6, 9 or 12 months. It was suggested to us in some quarters that we might issue three-months bills also, but this would then have been undesirable, as the bills would have matured at a time when it would have been inconvenient for us to meet them. Since January, however, we have been issuing bills of this description". At the end of each of the four years 1917-18 to 1920-21, the outstandings of these floating liabilities amounted to about Rs. 43 crores. They reached the maximum of Rs. 61 crores in 1921 and stood at Rs. 53 crores at the close of 1921-22. By the end of 1922-23, they were reduced to Rs. 21½ crores and to only 2 crores by the end of the following year. By July, 1924, they were entirely paid off. It is superfluous to add that a resort to this kind of floating liability on a large scale is suggestive of the unhealthy condition of state finances as well as the intervention of the Executive Government, as currency authority, in the normal operations of the money market.

18. *Additional Taxation Imposed to meet the Deficits.*—It was found in 1921, that in spite of the increases which had been effected in the previous years, in the amount of taxation, there was a wide gap yawning between the revenue and the expenditure of the Central Government; and further additions were made to the burden of the people in order to bridge the gulf. The accounts for 1919-20 showed a deficit of Rs. 15·7 crores, and according to the revised estimates for 1920-21, the deficit for that year was expected to amount to over 11 crores. To meet the situation thus created, all possible avenues of income were searched and the promising ones were tapped. Increases in railway rates and in postal charges were effected in 1921, but reliance for additional revenue was placed mainly on the two comparatively elastic and productive sources, *viz.*, customs and income-tax. Customs yielded Rs. 16 crores in 1917-18 and Rs. 17·3 crores in 1918-19. The amount realised in 1919-20 was Rs. 21½ crores. Though the budget estimate for 1920-21 was Rs. 24¾ crores, the actuals turned out to be Rs. 31 crores, thanks to the rush of imports ordered during the boom. In the budget for 1921-22, as much as Rs. 37¾ crores was expected, the interest be-

ing due to the additions made to the import duties on liquors, sugar, tobacco, matches, articles of luxury such as motor cars and the enhanced general import duties which were raised from 7½ to 11 per cent. Owing to the sudden depression which had set in, however, the anticipations were not realised and the actual yield of customs was only Rs. 34½ crores. With another large deficit staring them in the face in 1922-23, Government decided to give another turn to screw. An all-round increase was made in customs duties, ad it was calculated to yield about Rs. 15 crores. The actuals for 1922-23 were, however, Rs. 41 crores as against Rs. 45½ crores, finally adopted in the budget; and out of this latter amount, 9 crores was expected to accrue from the enhancement of duties effected.

Between 1919-20 and 1923-24, the customs revenue had increased roughly by Rs. 20 crores, having risen from Rs. 21 to 41 crores, and the rates of duty on almost all important articles of import had been put up, luxuries being subjected to a duty of 30 per cent. Export duties on hides and skins, on jute, raw and manufactured and on tea and rice continued, and an excise on kerosene was newly added to the excise duty on motor spirit. The high tariff did not, however, produce the anticipated results owing to the prevailing depression, and it was certain, it should be noted, that if the enhanced rates were maintained, the yield would automatically go up with the revival of trade and industry. The second period, on a review of which we enter in the next Chapter, will show this beneficial effect on the national exchequer, and it will be seen how it facilitated the task of Sir Basil Blackett, the new Finance Member, though of course, the tax-payer would continue to grumble at the burden he was to be called upon to carry. Like the customs duties, the tax on incomes had been successively screwed up, particularly in the rates on the higher incomes, and both in 1921-22 and in 1922-23, the ordinary tax and the super-tax were subjected to increases on the principle of progressive taxation of incomes. The yield of this source of Government revenue had already risen from Rs. 9·3 crores in 1917-18 to Rs. 22·4 crores in 1919-20. But the story of the customs revenue was repeated in the case of this tax, and owing to unsatisfactory economic conditions, the higher rates did not yield correspondingly increased returns. By the end of our first period, the limits of the two sources of revenue appeared to be fixed roughly at Rs. 41 and 19 crores respectively.

CHAPTER IV.

SECOND PERIOD—RECOVERY AND RECONSTRUCTION.

(A) General and Railway Revenues.

1. *Economic Revival.*—It will be a pleasing experience now to pass from a period of depression and deficits to an era of financial recovery and reconstruction. In this, our second period, we have balanced budgets and surpluses; and opportunities are provided and utilised for the reconstruction and the improvement of the machinery of national finance. We find that during this period, important problems of development and reform associated with railway finance, tariffs, provincial contributions, taxation, exchange and currency and public debt were discussed and solutions for them were attempted. The causes which favoured these efforts were (*i*) economic revival, (*ii*) retrenchment and (*iii*) the maintenance of a high level of taxation. Statistics of foreign sea-borne trade may be taken to afford a good indication of improvement in the economic situation. The following comparative figures in this regard are interesting:—

Sea-borne Trade of India.

(*In Crores of Rupees.*)

	1920-21.	1921-22.	1922-23.	1923-24.	1924-25.
Total merchandise imports..	347·5	282·5	246·1	237·1	253·3
Total merchandise exports..	267·7	248·6	316·0	363·3	400·2
Net exports of merchandise.	—79·8	—33·9	+69·8	+126·1	+146·8
Net imports of treasure ..	8·6	12·2	60·5	49·5	94·0
Excess of imports ..	—88·3	—46·1	9·3	76·6	52·8

The swing of the pendulum of the balance of trade from a distinctly unfavourable to the decisively favourable side, is unmistakably reflected in the above figures. Another indication of the general tendency of economic conditions to return to a normal and stable state, is provided by the gradual change in the general index number of prices in India.

GENERAL INDEX NUMBER OF PRICES.

(*Prices in* 1873=100.)

1914 ..	147	1922 ..	232
1916 ..	184	1923 ..	215
1918 ..	225	1924 ..	221
1919 ..	276	1925 ..	227
1920 ..	281	1926 ..	216
1921 ..	236	1927 ..	202

2. *Drastic Retrenchment called for in Military Charges and in Railway Expenditure.*—When it was assumed on the side of Government in the beginning of the decade, that the depressed condition of national finances was not a passing phase and therefore rendered continuous additions to taxation imperative, it was taken for granted that there was little room for retrenchment in expenditure. The non-official feeling in the legislature and outside, however, was different; and the Inchcape Committee was appointed to enquire into the question. Great credit is due to this Committee for the close scrutiny to which it subjected the whole field of Government expenditure and the severe strictures it found it necessary to pass against the prevailing careless extravagance in the various State services. Taking the budget estimates for 1922-23 as the basis of calculation, it proposed a net total reduction in expenditure of no less than Rs. 19 crores. It was recognised that all the cuts suggested, could not be immediately and fully given effect to. Even allowing for this factor, however, the Committee believed that its recommendations, if carried out, would go far "toward solving the problem of restoring India's finances to a secure basis". The public's critical attitude on the question of retrenchment was thus completely vindicated, and the weakness of the position taken up by the spokesmen on the Government side, was thoroughly exposed. One or two observations of the Retrenchment Committee may be usefully quoted here to illustrate the character of its comments on Government expenditure. Military charges have ever been a heavy drain on the resources of the Government of India; and though the vital importance of providing for national defence on an adequate scale has been admitted, it has been felt that the country cannot possibly stand the prevailing scale of expenditure. The Committee remarks on this question as follows:—"The expenditure which has been incurred in the past may have been inevitable, but the question is whether India can afford to maintain military expenditure on the present scale as an

insurance against future eventualities. In our opinion the repeated huge deficits of the past few years, in spite of the imposition of heavy new taxation, have made it abundantly clear that India cannot afford this expenditure." It should be remembered that as against 30 crores of rupees actually expended on the military services in 1913-14, the budget estimate for 1922-23 put down the expenditure at no less than Rs. 67 crores. The concrete recommendation of the Committee in this behalf, therefore, was that the total net military budget for 1923-24 should be fixed at Rs. 57¾ crores, subject to such addition as may be necessary on account of the delay which must ensue in carrying out the proposed changes and that military expenditure, after a few years, ought to be brought down to a sum not exceeding Rs. 50 crores. This goal has not yet been reached even after the lapse of nine years and in times of very low prices!

Another important element—and a very disturbing element too—in the financial position of the Government of India was the finance of the Railways, both managed directly by the State and by companies on its behalf. As this finance still formed part of the general finances of the nation, increase in railway income and expenditure made all the difference between financial prosperity and stringency in any year or period of time. The following statistics will show at a glance how matters appeared in this respect at the stage at which we now stand:—

RAILWAY FINANCE.

(In Crores of Rupees.)

	1913-14 Actuals.	1921-22.	1922-23.	1923-24.
Gross traffic receipts ..	56·3	81·6	93·2	94·6
Subsidised companies ..	·1	·2	·2	·2
Total receipts ..	56·4	81·8	93·4	94·8
Working expenses ..	29·3	65·6	65·9	61·0
Surplus profits paid to companies ..	·6	1·0	·6	1·1
Interest on debt ..	10·9	16·6	16·3	17·5
Other items (interest on capital contributed by companies, annuities &c.) ..	8·4	8·6	9·3	8·7
Total expenditure ..	49·2	90·8	92·1	88·3
Net receipts ..	7·1	—9·0	1·3	·6·5

3. *Railway Finance and the Inchcape Committee.*—Instead of being a substantial asset, the Railways had become a heavy liability for the nation and only aggravated the seriousness of the whole financial position. The Retrenchment Committee came to the deliberate conclusion, on a careful review of the relevant statistics, that both capital expenditure and the working expenses were on a scale that was not justified by the real needs. It laid down an important proposition in this regard, which is worth quoting in full. It observed: "We are of opinion that the country cannot afford to subsidise the railways and that steps should be taken to curtail working expenses as necessary in order to ensure that not only will the railways as a whole be on a self-supporting basis, but that an adequate return should be obtained for the large capital expenditure which has been incurred by the State. We consider that, with economic working, it should be possible for the railways in India to earn sufficient net receipts to yield an average return of at least 5½ per cent. on the total capital at charge. The average return to the State during the three years prior to the war was 5 per cent., and in view of the fact that large amounts of additional capital are being raised at 6 per cent. or over, we think a return of 5½ per cent. can not be regarded as excessive." This was undoubtedly a sound business principle which had to be strictly followed if the State's commercial undertaking of such dimensions and importance as the railways, in which the Indian tax-payer's money had been invested on a lavish scale, was to be a really paying proposition. It is worthy of note from the point of view of the development of the nation's finances that in deciding the amount of the Central Government's deficit which would have to be made good initially by provincial contributions, it had been assumed by Lord Meston's Committee that the Central Government would receive no less than Rs. 10¾ crores as net annual revenue from the railways. Failure in this respect goes a long way in explaining the part the railways played in contributing to the perilous state of the country's finances during the decade under review. It is equally noteworthy that in the opinion of the Retrenchment Committee, the suggested 5½ per cent. return from the railways would "not merely go far towards bridging the deficits of the Central Government, but should, with the economies which we recommend in the case of other Departments, make it possible to give much-needed relief to the Provinces by a substantial reduction in the amount of their contributions." We shall return to this subject in a moment.

4. *Results of Retrenchment Effort.*—Effort was made to give effect to the cuts in expenditure recommended by the Inchcape Committee, as quickly as and to the extent to which circumstances permitted, and account was taken even in the budget for 1923-24, of some of the cuts which Government expected to be able to make in the expenditure during that year. The Finance Member pointed out in his speech that

a fair proportion of the total reductions recommended by the Committee were either automatic reductions on the 1922-23 figures or actual retrenchment which Government itself had been able to effect in advance of the receipt of the Committee's recommendations. In the non-military part of the budget, Government proposed to reduce expenditure by a total of Rs. 6·6 crores against the Rs. 8½ crores suggested by the Committee. Military expenditure was taken at Rs. 62 crores, including Rs. 1·6 crores for expenditure in Waziristan, and it showed a reduction of Rs. 5¾ crores over the total of 67¾ crores for 1922-23. Further reductions in military charges and the question of the reduction of troops, were being discussed between the Government of India and His Majesty's Government, and the Finance Member declared:—"If these reductions and the others which have been agreed upon could have been fully and effectively in operation by the 1st of April 1923, the net military budget for 1923-24 would be Rs. 57·7 crores but a sum of Rs. 4·45 crores has to be allowed for special expenditure in Waziristan and for the fact that the reductions can not be in full force throughout the year." The upshot of the efforts at retrenchment so far as immediate results were concerned, was that "as compared with the original budget estimate of expenditure for 1922-23, of 215·27 crores, inclusive of the working expenses of commercial departments, our total expenditure for 1923-24, taking sterling expenditure at the rate of exchange of 1*s*. 4*d*. per rupee, is estimated to be 204·37 crores, a reduction of 11 crores in spite of an increase of 1¾ crores for interest." The following figures will give a fair idea of the changed financial position:—

CENTRAL REVENUE AND EXPENDITURE.

(In Crores of Rupees.)

	Accounts, 1922-23.	Budget estimate, 1923-24.	Revised estimate, 1923-24.	Budget estimate, 1924-25.
Total Revenue ..	121·4	134·9	131·9	131·2
Total Expenditure ..	136·4	134·0	129·8	131·2
Deficit ..	15·0	..	..	..
Surplus ..	..	·8	2·0	0·03

5. *Railway Contribution to General Revenues.*—Indian finance had often been described as "a gamble in rain" and also as "a gamble in railways." India being a predominantly agricultural country, its general economic and financial condition in any given year, is governed by the state of its principal crops which are, however, dependent on such an uncertain factor as sufficiency and timeliness of the rains. The Finance

Member who has to frame his budget estimate far ahead of the monsoon and in ignorance of what is going to happen, has no definite data to rely on, and his work must largely be of the nature of speculation; and consequently, it is often likely to turn out to be a gamble, which, however, in the circumstances, can not be helped. As the net income from the railways forms no unimportant part of the total revenue of the Government of India, any unexpected change in the financial results of their working, depending as they do, on general agricultural and trade conditions, must cause embarrassment to the Finance Member. Any scheme under which the relations of railway finance towards the general national finances, were so arranged as to ensure a definite annual contribution from the former to the latter, would be welcome both to Government and to tax-payers. There was likewise a second aspect of the subject. On behalf of the railway interests, as distinguished from the interests of the ordinary citizen, it was contended that the management of this large commercial undertaking of the State could not be satisfactorily carried on so long as railway finances were mixed up with the general finances and the railways were not masters in their own house, controlling their capital outlay and running the concern as a business proposition, without being subjected to the vagaries of the national budget and accounts. Sir Basil Blackett put the advantage of the separation of railway finance from general national finances, thus:—"I know of no reform which offers greater attractions and greater benefits to our finances and our railways alike than a definite separation, if it can be achieved. The condition of affairs hitherto prevailing has inevitably tended to an alteration between raids by the railways on the taxpayer and raids by the taxpayer on the railways." The new settlement provided that instead of the whole of the incomings and the whole of the outgoings of the railways being regarded as a part of the general revenue and expenditure transactions of the Government of India, the national revenues were to receive from the railways (1) a sum sufficient to pay in full the interest on the capital invested in the commercial lines, (2) an additional dividend of five-sixths of one per cent. on that capital, and (3) a share of one-fifth of any surplus earnings that may be secured in addition. While this contribution was definitely guaranteed to the national exchequer from the railways, the latter were to be allowed to carry on as an independent business with the right to retain any surplus over and above what is paid to Government and to apply it to the creation of reserves which would be available for the improvement of the service rendered to the public.

6. *How the Contribution was worked out.*—The chief advantage claimed for the new settlement was described in the budget speech of the Finance Member in 1924, as follows:—"The taxpayer will receive a regular and increasing contribution from his investment, largely independent of fluctuations in railway receipts and expenditure, and the

railways will be able to spend money according to the real needs of the railway system, unimpeded by the necessity for conforming to the vagaries of budget figures and the requirements of budget accounting. The railways will become a real commercial undertaking managed on commercial lines and the taxpayer will get the benefit of commercial accounts and management." The settlement was calculated to give freedom to the railway management to utilise funds for building up reserves and to stimulate them to improve their whole working, without being interfered with, though the general control of the Legislature over the entire undertaking would remain intact. We shall have occasion to show later on how the new system actually operated and whether the hopes about its beneficial results have been fulfilled. It is, however, necessary to observe here that as the Indian railways are almost wholly State property and are also predominantly under State management, and as railway reserves and depreciation funds must form part and parcel of the total liabilities of the Government of India, the capital position, if not the annual revenue, of the one can not, in the last resort, be entirely divorced from the financial situation of the other. The independence of the railways in the matter of capital outlay and borrowing for that purpose, has its obvious limitation in view of the financial position of the Government of India. The taxpayer, as the ultimate gainer or loser, finds his interests thus intimately bound up with the proper management of the State railways. The manner in which it was finally decided to work out the railway contribution (with a slight change in the arrangements described above), and the general position of railway finances are illustrated in the following table:—

CONTRIBUTION FROM RAILWAYS TO GENERAL REVENUES, 1927-28.

(*Based on actuals,* 1925-26.)

(*In Crores of Rupees.*)

	Rs.	Rs.
1. One per cent. on capital of Rs. 600 crores at charge, commercial lines ..		·6
2. (*i*) Gross traffic receipts, commercial lines ..	98·0	
Interest on Depreciation and Reserve Fund Balance ..	0·5	
Dividend on investment in branch lines, etc..	0·06	
Subsidised Companies' share of surplus profits ..	0·3	98·9
(*ii*) Working expenses, commercial lines ..	62·6	
Indian States' & Railway Companies' share of surplus profits ..	1·7	

		Rs.	Rs.
	Interest.		
	On capital at charge, commercial lines.	21·8	
	On capital contributed by States & Companies ..	1·6	
	Land and Subsidy ..	0·04	
	Miscellaneous expenditure ..	0·2	
	Contribution at 1 per cent. on capital at charge, commercial lines ..	6·0	94·2
	(*iii*) Surplus ..		4·7
	(*iv*) Contribution of one-fifth of surplus ..		0·9
3.	(*i*) Total contribution from railway revenues [1 *plus* 2 (*iv*)] ..		6·9
	Deduct—Loss on strategic lines borne by railway revenues:		
	(*i*) Interest on capital of 30·9 ..	1·3	
	(*ii*) Loss in working ..	0·1	1·4
	(*ii*) Net payment due from railway to general revenue in 1927-28 ..		5·4

(B) PUBLIC DEBT AND CURRENCY SYSTEM.

7. *India's Public Debt.*—The state of a nation's financial health can be guaged, among other ways, by enquiring into its position with reference to public debt, currency and foreign exchange. Since we have characterised the second period of the decade of our study as an era of consolidation and improvement, it is now necessary to turn our attention first to these questions, and the discussion of other and comparatively minor problems may be conveniently taken up later in the course of this survey. Now, with regard to the public debt, the chief points for consideration are: (1) what is its size, (2) what portion of it is productive and what portion is unproductive, (3) what is the rate of interest the debt bears, (4) what provision has been made for sinking funds and repayment, and (5) to what extent efforts have been made (and have succeeded) to convert debt so as to reduce the charge on account of interest. India's public debt before the war, as we have shown in the preceding chapter, was small compared with the volume it has reached in recent years; and most of it had come to be productive. What with recurring deficits and with our war gift to Great Britain, the unproductive part of the national debt gradually increased in size, and with the high rates of interest at which money had to be borrowed

during the war period and a few after-war years, the burden of the national obligations became heavy. It is needless to point out that the productive debt represents mostly national investment in the railways and irrigation works. It would be interesting to recall here the observations the Finance Member made, with an obvious glow of pride, in 1915, in describing the country's preparedness to face the crisis of the Great War. He said:—"But more important still is the credit which India has established, through good and evil times alike, by restricting her outlay to her available means, and so avoiding the accumulation of wasteful debt. Almost the whole of her debt to-day represents productive outlay, normally yielding a return far in excess of the interest which she has to pay on the amount borrowed; sufficient indeed to cover also the interest on the small margin of debt which can be described as unproductive, and still to leave an ample margin. She is thus entirely exempt from the deadweight of interest charges which hamper the finances of most Western countries, and will hamper them to a vastly increased extent by the time this war is finished." Little did he dream then that in a few years' time, India's public debt position would seriously deteriorate.

The total public debt of India at the beginning of the present century was roughly £200 million, of which about £60 was unproductive or, to give it its technical name "ordinary" debt. On 31st March, 1914, the two figures were respectively £272 and £12·8 million. In that year, the total interest charges amounted to £9¼ million, and the return from the capital invested in the railways and irrigation works, was £15¼ million, so that there was a surplus of £6 million of revenue left from the capital undertakings after the interest charges on the entire public debt had been met. If the debt position (all classes and kinds of debt being taken into account) in 1925 is compared with that of the year 1914, the result is roughly as follows:—The total debt (this includes about 97 crores owed to the Government of India by Provincial Governments) in 1925 was a little over Rs. 1,000 crores, and this was double the figure for 1914. In 1925, the debt in India was almost equal in amount to that in England, while in 1914, this proportion was one-third and two-thirds. The ratio of unproductive debt, which, it has been already pointed out, was extremely small, increased between 1914 and 1925, to one-third of the whole. When the era of deficits and depression had passed away and the demand for expenditure on capital account for public works, was keenly felt, it was essential that the public debt position should be reviewed and consolidated and that provision should be made to improve Government's credit and to place it on a sound footing. Regular sinking fund arrangements and debt conversions at suitable opportunities, are methods adopted to achieve this end. Very soon after he assumed charge of the management of India's finances, Sir Basil Blackett turned his attention to the subject of the national debt, and the first question that claimed his attention was that relating to the provision for sinking funds.

8. *Sinking Fund Provision.*—Even then provision was being annually made in national expenditure for this purpose, and it was thought desirable to place it on a systematic and intelligible basis. It is interesting to notice how this arrangement actually operated, and the explanation will, at the same time, throw light upon the manner in which India's unproductive debt has been reduced at a rapid pace. In the words of the Finance Member himself, "so long as we have a considerable annual programme of new productive capital expenditure, any provision for sinking funds operates, not to reduce the net total of our debt but to reduce the amount of it which is unproductive, and the amount provided becomes in effect a contribution out of revenue towards productive capital expenditure." The sinking fund was not a fund allowed to accumulate at compound interest or a fund that was annually used straight off to cancel Government securities. It was a provision out of revenue which was utilised as part of the amount that would otherwise have been wholly borrowed for capital expenditure; and to that extent, the unproductive debt is shown as having been reduced, while the total of the national debt is not thereby affected. The provision that was made for the sinking fund in 1923-24, for instance, was about 4½ crores and consisted of 1½ per cent. depreciation fund set aside against two 5 per cent. loans, some railway annuities and so on. The Finance Member proposed that the whole public debt should be analysed into different classes, periods of repayment should be decided upon in view of their nature and then the provision to be made annually, should be fixed on the basis of such definite and purposeful considerations. He also replaced the misleading term "sinking fund" by the more significant name, "fund for reduction or avoidance of debt". He put the advantages of the system in the following words:—"It is essential that we should maintain our credit both internally and externally unimpaired, if we are to carry through successfully the business of renewing maturing debt and raising the new capital which we require. Our provision for reduction or avoidance of debt assists us in this task in two ways, for it not only reduces the amount that we have to borrow, but it also gives confidence to our creditors and to those whom we may want to induce to become our creditors in the security which we have to offer to them, and thereby serves to keep down the rate of interest on our new borrowings. Nor must the value of such provision as an emergency reserve be overlooked."

In this and other reforms of this character, Sir Basil Blackett brought his knowledge of the essence and the practical working of the financial system of Great Britain, to bear on the solution of the financial problems of India. Another such question, which he tackled, was in connection with the establishment of the Provincial Loans Fund, the purpose of which was "to systematise the arrangements by which advances are made by the Central Government to the Provincial Governments." Upto that time these advances were made direct to the Governments concerned out of the balance of the Central Government, on terms and conditions as to the rate of interest and the period of amortisation decided in a piecemeal fashion. It was proposed to regulate these borrowings according to some definite principles. The Finance Member even looked forward to the day when the fund might be administered by an Indian body corresponding to the National Debt Commissioners or the Public Works Loans Commissioners in England. Not only advances to the Provincial Governments but also the railway debt of the Government of India might ultimately be separated from the ordinary debt and be raised, "subject perhaps to a Government of India guarantee, not on the general credit of the revenues of India but on the security of the assets of the Provincial Loans Fund and the railway undertakings of the State respectively."

9. *Debt Conversions.*—As regards conversion operations, favourable conditions in the money market, ample supplies of loanable capital and low or falling rates of interest, furnish a welcome opportunity to Government to float conversion loans. In such circumstances, when short term debt falls due for repayment, Government is in a position to dictate terms to its creditors, if money happens to be cheap; and it can reborrow the amount of the debt on better terms as to the rate of interest and can ease the burden of the exchequer and of the tax-payer. This procedure may be instructively illustrated by a brief account of the relevant operations of the year 1925-26. The ways and means position of Government during that year was very easy, and the incomings through various sources, reserve and depreciation funds connected with the railways and postal cash certificates, for instance, were larger than the outgoings, and the conversion of early maturing bonds could be conveniently taken up. Government wanted a market loan of only Rs. 12 crores to meet its capital requirements, but it utilised its opportunity to float a conversion loan which yielded no less than Rs. 30·6 crores, which was devoted to the conversion of bonds maturing in the years 1925 to 1928 to the extent of over 25¾ crores, into the 5 per cent. income-tax free loan of 1945-55 and to the extent of 4¾ crores into the new issue of 10-year bonds liable to the income-tax. The conversion certainly cost Rs. 87·6 lakhs immediately, but about Rs. 23 lakhs out of this amount, represented the premiums on 1925 and 1928 bonds which would have had to be paid in any case. As against the balance of Rs. 64 lakhs, paid in cash, two advantages were secured, viz., an annual saving in interest to the tune of 18 lakhs, as a result of the conversion, and secondly, 4¾ crores of debt became subject to income-tax instead of being income-tax free. The conversion had the further effect of reducing liabilities for the repayment of maturing

loans during the next three years by nearly 29 crores and particularly a reduction of about 18 crores in the liability connected with 6 per cent. bonds maturing in 1926. This policy was consistently pursued, and it was claimed that combined with the regular provision for the reduction and avoidance of debt, the habit of borrowing for productive purposes only, had the beneficent effect of lowering the rate of interest and improving India's credit in England. In 1926, Government could borrow in the Indian market at the rate of 4·6 per cent. subject to income-tax as compared with 6 per cent. tax-free in 1922 and the charge on the budget for 1927-28 for interest on dead-weight debt was about 5½ crores less than it was in 1923-24,—a saving to the tax-payer considerably larger than the provision for reduction or avoidance of debt. The conditions were generally so favourable that four years after 1923, it was found unnecessary to borrow in London and the Indian market was able to supply such amounts as were required for the State's capital programme and for the conversion or redemption of national debt. The debt situation in 1928 was this: Since March 1923, increase in aggregate debt was 113 crores, the productive debt increasing by 189 crores and the unproductive debt decreasing by 76 crores. It was hoped that the whole debt due to the revenue deficits of the earlier years would be liquidated by the end of 1928-29 and that in another twelve years' time, unproductive debt would be entirely wiped out.

10. *The Exchange Ratio.*—Let us now turn to the problem of exchange and currency. It may be recalled that after the lamentable failure to maintain the exchange ratio at 2*s*. in 1920-21, Government resolutely refused to attempt stabilisation and decided to wait upon events. Its accounts, however, continued to be kept on the basis of a 2*s*. rupee, and in consequence, the variation between that artificial or nominal rate and the prevailing market rate had to be shown in the books as credits or debits on account of exchange in respect of transactions involving remittance of funds to and from the Secretary of State. These "gains and losses" were first recorded in a suspense head and then distributed over the appropriate accounts, and it was decided from time to time how the balances were to be disposed of. For the practical purposes of the budget, however, an average rate had to be assumed in view of the prevailing economic conditions, and an element of speculation entered into the calculation and the financial arrangements, which was unavoidable. The average rate assumed for the budget for 1921-22 was 1*s*. 8*d*. and the actual rate fell far below that figure. During the next two years, exchange stood in the neighbourhood of 1*s*. 4*d*. and 1*s*. 4½*d*.; and for 1924-25, it was taken at 1*s*. 4½*d*. for purposes of the budget, but actually it worked out at an average of 17½*d*. For nearly half of that year, it was steady at 18*d*., and that figure was taken for the budget for 1925-26. The economic trend indicated by the statistics of India's balance of trade which we have

quoted on a preceding page, may be supposed to account for the hardening of the exchange rate at this time. As general economic conditions were propitious, the question was asked by many, 'had not the time arrived for stabilising the exchange and was it not meet and proper that it should be stabilised at the old familiar rate of 16*d.* which had been both the actual and the statutory ratio for a number of years and which, therefore, appeared to be the natural ratio for India?'

11. *Government's Attitude to the Exchange Problem.*—These questions were actively canvassed inside and outside the Legislature, and the Finance Member thought it imperative to discuss them and to explain at length the Government attitude towards them in his budget speech of 1925. He put in a spirited defence of Government's exchange policy against the vigorous attacks to which it was being subjected, specially in view of two non-official bills, seeking to fix the rupee-gold ratio at 16*d.*, which were coming up immediately before the Legislature. Indian currency and exchange has been a subject of perpetual controversy between the Government and the people in this country, and the budget speeches even of Sir George Schuster, including that made on 7th March, 1932, had to deal with the problem at some length. Sir Basil Blackett's arguments in his budget speech of 1925 have a particular interest for us in as much as they foreshadow the trend of the discussion of the exchange question during and after the enquiry of the Hilton Young Commission and likewise enable us to take in the situation, as a whole, and as it developed in the course of the next few years. It ought to be possible for us, as unprejudiced and scientific students of economic problems, to appreciate at their true worth the views that have been advanced on the two sides of the controversy. Fortunately, there is complete agreement among economists as to the main theory of international exchange. Dispute, however, arises in deciding whether a particular rate of exchange is justified by prevailing and prospective conditions and what effects it will have upon the people who are directly and indirectly affected by it. In his very first budget speech, Sir Basil Blackett put forward the various considerations that have to be borne in mind in the discussion of the exchange question, viz., (*i*) the sterling obligations of Government and private individuals, (*ii*) the relative importance of stability of exchange and stability of internal prices, (*iii*) monetary stringency and inflation that may be necessitated by the adoption of a particular ratio and (*iv*) the effect on exports and imports and the interests of those who are associated with them. Difference of opinion is due, in spite of agreement regarding theory, largely to the fact that stress is laid specially on one or other of the above points to the neglect of the rest.

12. *Sir Basil Blackett's Arguments.*—The attack of the Finance Member in his budget speech of 1925 was chiefly levelled against what is called the "hoary old fallacy" that "a high exchange benefits the

importer of goods from abroad and a low exchange benefits the primary producer and the exporter" and that this loss and gain can be anything but a passing phenomenon which disappears with the adjustment of prices. According to the economic theory of foreign exchange, broadly stated, the exchange ratio represents or registers the relation subsisting, at any given time, between internal and external levels of prices or purchasing power. Obviously, alterations in the price levels and in the ratio will act and react on one another. When the ratio is fixed, internal and external prices will adjust themselves to each other; and when it is unstable, it will have a tendency to move up and down according to the movement of prices before it settles down at a fixed point. The adjustment is normally brought about by changes in the volume of exports and imports of merchandise and the movement of the precious metals, particularly of gold. Our experience during the post-war period and also in recent months here and in the outside world, amply demonstrates the truth of the general economic theory. Arguing on this basis, Sir Basil Blackett pointed out that "when, as has been happening in the last twelve months, world prices have been moving up outside India and a natural stimulus has thus been given to the world's demand for India's produce, the effect of a rising rupee exchange has been in the main to keep rupee prices from rising in sympathy with world prices," and stated that during the same period, prices of goods imported into India had gone up considerably in terms of sterling, while remaining fairly steady in terms of rupees and similarly, prices of India's exports had remained fairly constant in terms of rupees while, at the same time, going up in terms of sterling. He explained the meaning of this phenomenon by saying that the exporter had been receiving a larger amount of sterling for his exports, but when his sterling was converted into rupees, the amount of rupees proved to be much what it had been before. To put it in other words, rising external prices were prevented from influencing Indian prices by a rising and higher exchange ratio, and if the ratio had remained at 16*d.*, for instance, instead of rising to 18*d.*, internal prices would have gone up in sympathy with sterling prices. In the result, argued the Finance Member, the increase of about 12½ per cent. in the sterling value of the rupee had neither discouraged Indian exports nor encouraged imports into India, and if the latter effect had taken place, the value of the rupee would have been brought down in consequence.

13. *His Plea Examined.*—The dispute in this matter really turned not so much on the correct theory of foreign exchange as on the divergence of view as to what was best suited to the conditions and needs of India, taken as a whole. It could not be denied by the contending parties that the economic condition of people is influenced by the ratio. The capacity and the function of the national currency authority to manipulate the exchange rate by expansion and contraction of monetary

circulation are equally undeniable. In fact, Sir Basil Blackett, in his budget speech referred to above, took credit to Government for having, in the preceding autumn, intervened to make large purchases of sterling in order to check the rise in exchange for the time being, and urged this action as a refutation of the charge that it was Government of India's policy to push exchange up. What was mainly in dispute, therefore, was the comparative effect of the rival ratios on the economic conditoin of the people of India as a whole. It was contended on behalf of Government that the loss on exports was balanced by the gain on imports, and that the producer was benefiting in any event, by the large imports of cheap gold. And if the producer is also the consumer of his own produce, he is not affected at all. The effect of a lower exchange being a rise in the prices of most commodities, it was contended that the producer has no right to make a gain at the cost of the consumer, and possibly the same person may be both. As to the chief objection of the supporters of the 16*d*. rupee to the 18*d*. ratio, the case of Government was almost given away when Sir Basil Blackett asserted that it was owing to the saving Government made on its remittances at the higher ratio that there were surpluses in the budgets and that but for this, additional taxation would have been inevitable and the remission of Provincial contributions would have become impossible. This was tantamount to the admission that the gain of the public exchequer was purchased at a heavy cost borne by the mass of the population; and it was not demonstrated beyond dispute that such sacrifice claimed from the large producing classes and the industries of the country generally, was imperatively demanded by paramount national interest. No Government measure is calculated to be either advantageous or detrimental to all classes alike; and as in the matter of granting protection to certain industries, so in the case of the exchange ratio, the ultimate decision must turn upon a balanced view of what is in the best interest of the nation generally.

14. *Royal Commission on Indian Currency*, 1925-26.—The above discussion is calculated to clear up the issues which the Hilton Young Commission had to deal with when it was called upon, in the middle of 1925, to consider the existing currency system of India and to recommend any modifications it thought necessary. The position, in the words of the Commission, at the time was this: "The 2*s*. ratio, passed in 1920, remained on the statute book, and was ineffective for purposes of tender of gold to the currency office. By January, 1923, the tide had definitely turned; exchange recovered to 1*s*. 4*d*. sterling, and showed a general tendency to move upward. It reached the level of 1*s*. 6*d*. sterling in October, 1924, at which time it was equivalent to about 1*s*. 4*d*. gold. From that time till March, 1926, the upward tendency of exchange continued, but it was prevented from rising above 1*s*. 6*d*. by free purchases of sterling on the part of Government. Meanwhile

sterling was restored to parity with gold about the middle of 1925 and during the twelve months which have since elapsed, the rupee has been in the neighbourhood of 1*s*. 6*d*. gold." On a review of the world's monetary conditions and in view of the fact that a large number of countries had already returned to the gold standard, the Commission concluded that the gold parity of the rupee should be fixed and that the rupee should be stabilised at that parity forthwith. And it recommended that "the rupee be established in relation to gold at a rate corresponding to an exchange of 1*s*. 6*d*. for the rupee." The justification for this recommendation was, in the words of the Commission itself, as follows:—"The chief reason for this recommendation is our conviction, which has been formed and cumulatively reinforced during the progress of our inquiry, that, at the present exchange rate of about 1*s*. 6*d*., prices in India have already attained a substantial measure of adjustment with those in the world at large, and, as a corollary, that any change in the rate would mean a difficult period of readjustment, involving widespread economic disturbance, which it is most desirable in the interests of the people to avoid, and which would in the end be followed by no countervailing advantage."

The statistical evidence on which this conclusion was made to rest, consisted of the changes which had taken place in the rupee-gold exchange and the corresponding changes in the index number of Indian prices in the course of the preceding three years. During the eighteen months ending in June, 1924, while the rupee was worth about 1*s*. 3*d*. gold, the rupee price level ranged round a mean of about 176. In the succeeding year, while the rupee was rising to 1*s*. 6*d*. gold, the rupee price level fell below 160. After that, while the rupee remained or was held at about 1*s*. 6*d*. gold, the rupee price level ranged round a mean of about 158, with a tendency to fall in sympathy with world prices. On the strength of this evidence, the Commission felt convinced that "during the period of change, there was a mutual adjustment of prices and exchange, and that a substantial equilibrium was attained about the middle of 1925 and was maintained during the next year. Having persuaded themselves that internal conditions such as prices, wages, etc., had been adjusted at the 18*d*. ratio, the Commission held that an attempt to stabilise the rupee at 16*d*. as proposed by some, was sure to cause unwarranted disturbance in all economic relations, without being beneficial to any except debtors, exporters and employers of labour, and that too, during a short period of readjustment, which would have to follow the change.

15. *The* 18*d*. versus 16*d*. *ratio Controversy*.—There was a large volume of opinion in favour of the 16*d*. ratio, and it was contended that the currency authority should have and could have stabilised the rupee at that level when it had been reached and that it was not yet too late to do it. Sir Purushottamdas, a member of the Commission, led

the opposition to the 16*d.* rupee. His main argument was that full adjustment of prices and wages had not yet taken place, as was being supposed by the supporters of the higher ratio, and that if external prices declined further, as there was every probability that they would, the resultant fall in rupee prices would prove disastrous to agriculture and other indigenous industries. The 18*d.* ratio was not the outcome of a natural process of adaptation but was the product of Government's executive action of currency manipulation. The plea, on the face of it, reasonable enough, that it is wrong to change a ratio which has been stable for some time and to which economic conditions have adjusted themselves, was the strongest argument of the supporters of the 18*d.* ratio and it was repeatedly urged later whenever the restoration of the 16*d.* rupee was demanded. But the real point at issue was whether the Government and the Currency Commission were not carried away, in 1926-27, by the momentary trade revival of the time into believing that economic adjustment had taken place at the 18*d.* ratio and that the rupee could be maintained at that level without inconvenience and detriment to national interests. The determination to revive the prestige of the pound and the London money market, governed the decision in the middle of 1925 to restore the gold standard in England when sterling was yet 10 per cent. below parity, and the consequences of this step were soon visible. Similarly, though the catastrophic slump in prices of 1929-30 could not have been foreseen in 1926-27, Government's faith in the 18*d.* ratio was of a piece with their general optimism, and the effects of the higher rupee-gold ratio were not slow in making themselves felt. Sir George Schuster, later on, had to ask the critics of Government, though not necessarily in this connection, not to consider the financial situation as it developed after 1929, with reference to the years 1924-25 and 1925-26, which enjoyed special trade prosperity. This was a virtual admission that the hopes about stability of prosperous economic conditions entertained in 1926, were pitched rather too high. We comment on the optimistic delusion of Government in the next Chapter. The trump card in the hands of Government, in the ratio controversy has, of course, been the one referred to above, *viz.*, that a change in the gold value of the rupee would have a grave unsettling effect upon the finances of the country. In February, 1927, Sir Basil Blackett delivered himself as follows on this point:—"It is enough to observe that if the Government are correct in their contention that an arbitrary reduction in the exchange value of the rupee will bring no permanent benefit whatever to India while inevitably involving immediate and heavy sacrifices and losses, then surely the large sacrifice involved in the dislocation of the budget, though not necessarily the most serious of the sacrifices that would be incurred, is an important relevant consideration which it would have been folly for us to ignore or obscure." To confront one's critics with an accomplished fact not justifiable in itself and then to challenge them to support a departure from it, sums up the above attitude.

16. *India and Gold.*—On the recommendation of the Currency Commission, gold was demonetised and the gold bullion standard was adopted as the monetary standard of the country in the place of the prevailing exchange standard and of the gold currency standard as contemplated by the Fowler Committee in 1898. To ensure the success of the new standard, it was proposed to establish a central Reserve Bank which would take over from the hands of Government the function of the national currency authority and combine it with its credit or banking function. The Commission turned down a concrete scheme for a gold currency standard prepared in the Finance Department of the Government of India, on the grounds that it would be a costly and needless experiment, which had scarcely any chance of success since Government would not be able to secure the gold required from the U.S.A., the only country in the world which had it, and that it would induce a lowering of world prices through the large demand it would set up for the yellow metal, while reducing the value of silver hoards of the Indian masses. As a matter of fact, the recent catastrophic fall in prices has been attributed to the accumulation of huge quantities of gold in the U.S.A. and France, while India by its fruitless self-abnegation, lost an opportunity of making a beginning in building up an automatic and full gold standard, which was within its grasp. As the irony of economic developments would have it, Indian gold exports have, in recent months, gone to the rescue of Western nations in their exchange troubles, the rupee-gold ratio having once more collapsed together with the sterling-dollar exchange, and the recommendations of the Currency Commission have not been fully carried out. Sir Basil Blackett was not able to place the crown of the establishment of a Reserve Bank, which was the very pivot of the recommendations of the Currency Commission, on his achievements in financial reform; and his legislative proposal in this behalf was shipwrecked on the rock of difference of opinion between the Government and the public as regards the constitution of the controlling authority in that institution. Here we have one more telling illustration of the serious impediment which a lack of accord between the Executive and the Legislature,—between the Government and public opinion,—places in the way of essential national reforms in India. The development of the currency, exchange, banking and fiscal policy of the Government of India has, for generations, suffered from this grave defect from which it is not free even at the present moment.

17. *Provincial Contributions.*—By the year 1928, the Government of India was able to discharge its obligation to Provincial Governments by finally and completely extinguishing the annual contributions which the latter made to it in order to make up the deficit in the Central

Exchequer, created by the Meston Settlement. The ability of the Central Government to forego a total revenue of about Rs. 10 crores in the short period of four years, demonstrates the anxiety of that Government to get rid, as quickly as possible, of the Provincial contributions and also the decided improvement which had taken place in the general financial situation in the country during the administration of Sir Basil Blackett. (1) Revival of trade and industry, (2) maintenance of the high level of taxation which had been raised to meet the difficult years of the beginning of the decade, (3) retrenchment in expenditure effected on the recommendations of the Inchcape Committee, and (4) the saving on remittances rendered possible by a higher rate of exchange, combined to place in the hands of the Central Government, resources sufficient to enable it to relieve the Provincial Governments of the burden of their contributions. Sir Basil summarised the process of the extinction of this obligation in his budget speech of 1927 in the following words:—"Each of the three budgets laid before the Second Assembly was not only balanced at the time of its introduction but has presented India with an appreciable realised surplus of revenue over expenditure. The necessity of reducing the salt tax from Rs. 2-8 to Rs. 1-4 per maund in the Budget of 1924-25 postponed the beginning of the remission of the Provincial contributions. The Budgets for 1925-26 and 1926-27, relieved finally of the uncertainties of Railway Finance by the separation of the Railway Budget from the general Budget, effected a reduction in the Provincial contributions amounting to Rs. 3·75 crores or, if the Bengal contribution be included, a reduction from 9·83 crores by 4·38 crores to 5·45 crores. In addition, the Budget for 1926-27 signalised the demise of the unlamented Cotton Excise Duty. In its first Budget this new Assembly has before it proposals for the complete extinction, at any rate so far as the year 1927-28 is concerned, of the Provincial contributions."

It would be worth while to draw attention to the constitutional as well as the financial aspect of these contributions. It will be recalled that the Montague-Chelmsford Reforms had introduced the element of responsible Government in the Provinces while maintaining intact the autocratic government at the centre. Now the success of these reforms, partial and inadequate as they were, depended entirely on the smooth working of diarchy in the Provinces where responsible ministers administered "transferred subjects" which included such "nation-building services" as education, agriculture, sanitation, public health and so on. Inadequate resources impeded the progress of these departments, and most of the Provinces looked to the Central Government for relief from the Provincial contributions. Sir Basil Blackett described, in his budget speech in 1927, the situation most expressively in the following words:—"Ever since the Reforms were inaugurated, the Provincial contributions have been a millstone round the neck both of the Central Government and of the Provincial Governments, poisoning their mutual relations and hampering their very action. Their quality, even more than their amount, has strained the resources of the giver and the patience of the recipient. They have brought curses, not blessings, both to him who has given and to him who has taken. The year 1927-28 sets India free from this incubus."

The true financial and economic significance of the Provincial contributions deserves to be clearly understood. (1) The scheme of the complete separation of the sources of the revenues of the Central and Provincial Governments was an essential feature of the partial Provincial autonomy which was conceded under the Montague-Chelmsford Reforms. (2) The estimates underlying the financial redistribution effected under the Meston settlement were too liberal to accord with actual developments. They, therefore, put an undue strain on the resources of the Central Government. (3) Without fully satisfying the demands of some of the Provinces, *e.g.*, Madras, which had been long smarting under a sense of injustice with regard to the treatment they had received at the hands of the Government of India, the Meston Award made them impatient of delay in the remission of their contributions, especially in view of the pressure of the newly created diarchy. (4) Other Provinces, *e.g.*, Bombay and Bengal, which did not receive similar accession to their spending power under the Meston settlement, bitterly complained that their elastic sources of revenue had been taken away from them and that they had been financially crippled by it. (5) In effect, therefore, the increased spending power obtained by the more fortunate Provinces, though it benefited their people immediately, was really secured at the cost of the general tax-payer and, therefore, particularly of people in other Provinces who received no corresponding benefit. (6) The financial management and the working of the Reforms in the less fortunate Provinces that had to bear a heavy burden as also in the Central Government which had to impose it, were confronted with grave difficulties which caused considerable popular discontent in the country generally. (7) As the Government of India had to keep up taxation at a high level to get rid of the obligation of the Provincial contributions, its resources could hardly stand, without serious inconvenience, the strain of economic depression when it soon descended upon the land.

CHAPTER V.

THIRD PERIOD—LULL BEFORE THE STORM.

1. *Achievements of our Second Period Summarised.*—Between the era of stabilisation and consolidation which was associated with the financial stewardship of Sir Basil Blackett and the economic crisis which characterised the closing years of the last decade and through whose ordeal we are passing at the present moment, there intervened a short period of transition, in which signs of the coming storm were dimly visible. In 1928-29, the general economic situation was not certainly bad but it was not as good as it might have been expected to be. Not only could the pace of progress of the preceding few years not now be maintained, but steady deterioration of the position ensued from that year, and it soon appeared as if the ground which had been gained, during the Blackett period, was going to be all lost. What were those gains? (1) The budget was balanced, year after year, and there were substantial annual surpluses. (2) The level of taxation was high enough to permit a continued excess of revenue over expenditure, (3) and with improving trade and railway traffic, it was capable of yielding progressively increasing income. (4) A regular and systematic provision was made for reduction and avoidance of debt, out of revenue, the volume of unproductive debt was being steadily reduced, and by the process of suitable conversions, the charges for interest on the public debt were being lowered. The credit of Government in the money market, likewise, showed distinct improvement. (5) The growing margin between the revenue and the expenditure was utilised for the purpose of steadily reducing and ultimately extinguishing Provincial contributions, and (6) though the general tax-payer received no relief by any reduction of his burdens, the notorious cotton excise duty was abolished and thus a long-standing public grievance was removed. (7) On the advice of the Fiscal Commission, the country was committed to a policy of what is known as "discriminating protection". Action taken on the recommendations of the Tariff Board contributed to the increase in the customs revenue of the State and enabled it to grant bounties to promising indigenous industries, in exceptional cases. (8) The accounts of the commercial undertakings of the Government were being kept on a business basis, and it became possible to know the true financial position of the Posts and Telegraphs department and of the Railways. (9) Railway finance was separated

from the general national finance, and ample provision was being made for the supply of capital for the extension and improvement of the Railways. (10) Little difficulty was experienced by Government in securing from the public in India liberal contributions to the loans annually floated here, and it was normally unnecessary to resort to the London money market to finance its outgoings. (11) Stabilisation of the rupee-gold exchange at 18*d.* gave considerable advantage to the State exchequer, and internal prices were steady with a slight downward tendency.

2. *Was the Optimism Well-founded?*—In order correctly to appreciate the significance of the transition from the era of stability and prosperity indicated by the above characteristic features of the development of India's finances in the course of the six years 1923-29, to the period of depression, deficits and uncertainty that succeeded, resembling the state of affairs which prevailed during the first period of our review, it is necessary to bear in mind a few fundamental things. The assurance felt and expressed with respect to the stability and the strength of the superstructure of national finance, rested on the assumption that (1) the standard of living of the people in India and the condition of agriculture, trade and industry had been adjusted to the prevailing high level of taxation and of the rupee-gold exchange, (2) there would be a steadily, even though slowly, progressive increase in the revenue of Government and the savings of the people would render possible a readjustment and reduction of the tax-burden, (3) economic and social development in India could be financed without difficulty, and (4) the financial system, including the management of railways, exchange and currency, could absorb and survive without much trouble, shocks of temporary economic disturbances, coming from within or outside the country. Obviously, to the extent to which these assumptions were not based on an accurate estimation of the facts of the situation and to which the anticipations of the immediate future were oversanguine, the actual results were bound to prove disappointing. This is largely the explanation of the gradual deterioration and the ultimate debacle we have recently witnessed in the position of the national finances of India; and the correctness of this diagnosis of the trouble can hardly be challenged. It may be argued that the cheery optimism of the prosperous years 1923-28, was perhaps justified, at the time, by the circumstances; those who review developments over a sufficiently long period and from a distance from the scene of action, are, however, in any case, in a better position to form a correct estimate of affairs than the people who were actually occupied with them. The truth of the conclusion we have deduced is borne out by the fact that only twelve months after Sir Basil Blackett had presented his glowing picture, his successor had to express some hesitation in agreeing to the view that the amount of the final instalment of Provincial contributions

remitted in the previous year, had been permanently secured by a recurring surplus, and appeared half inclined to think that additional taxation would be essential to fill up the gap which he saw created. In 1930 he felt no hesitation in asserting that, "taking into account the unavoidable increase in expenditure, and even making allowance for the present depressed trade conditions the gap caused by the remission of the Provincial contributions has not, on a normal estimate of revenue and expenditure, been fully filled." In 1929, however, the Finance Member was not disposed to take such a pessimistic view of the situation which still appeared to his cautious mind as encouraging. He said:—"When one considers all the revenue which has been sacrificed by the Central Government in the past six years in order to give greater latitude to the Provinces or to provide some economic advantage to the country—nearly 10 crores of provincial contributions given up and in taxation 1¾ crores on cotton excise, 85 lakhs on machinery, 1½ crores on opium, to mention only the most important cases—and when one then realises how the other sources of revenue have moved towards filling the gap, I think one is justified in feeling confidence as to the future."

3. *Government Hesitating and Undecided.*—The question at issue here was whether this total loss of 15 crores of revenue had been made good by a corresponding increase in the productivity of the existing taxes and economy in expenditure and whether the future of the finances had been assured as a consequence. Though proposing additional taxation in 1930, the Finance Member appeared yet to be undecided as to the character of the depression, the effects of which were visible on the economic conditions and the finances of the country. He defended increase in taxation at the time on the grounds that further retrenchment and economy were not possible, that some of the existing sources of revenue were likely soon to disappear, that some beneficial expenditure had newly to be provided for, that the financial machinery had been working, for the preceding three years, on a dangerously low margin and that the needs of the Provinces after the new constitution had come into operation, had to be anticipated and cared for. As to the general economic conditions, he had no serious apprehensions and emphasised the view that the depth of the prevailing depression was being exaggerated in comparison with the very special period through which the country passed in the years 1924-25 and 1925-26. He said: "If we examine the trend of economic events in India since the end of the war, we find that the volume of imports and exports has, on the whole, shown a steady progression with two exceptional periods, first, as regards imports in 1920-21 and, secondly, as regards exports, in 1924-25 and 1925-26." Prices both of imports and exports had, likewise, been steadily declining, except that in the above-mentioned years high prices, combining with an exceptionally large agricultural produc-

tion, created an exceptional peak of prosperity. The conclusion which the Finance Member drew from these facts, was interesting and is worth quoting:—"Public opinion as to the course of Indian trade and general conditions, tends, I think at present, to be framed too much with reference to this special period, and though I do not wish to minimise the effects of the present depression, I think that if our view is cast back along a longer period of India's history, we shall find that the present conditions are not, in comparison, so black as they are some times painted and that the general economic course of the country has been one of steady advance."

4. *Deceptive Prosperity of the Second Period.*—Without attempting to read more than what lies on the surface, in the above expression of the Finance Member's views and without pinning him down to his prophecy that "a recovery from the present economic depression will not be long delayed," we may examine critically the trend of his ideas and of Government's financial policy in the crisis which descended upon India and the outside world in 1931-32 and which, in fact, was in the process of development during a few preceding years since the war. It is true that there was a sharp and sudden fall in prices in 1929-30 and that the decline steadily continued into the next two years. The Calcutta Index number of wholesale prices was 145 in 1928 and 142 in 1929. It fell to 116 in 1930, and in January, 1931, it was only 98. It remained in the neighbourhood of that figure throughout the whole of 1931. But to return to the opinion of the Finance Member above quoted, viz., that in taking a pessimistic view of the prevailing depression, the public was too much obsessed with a comparison between recent developments and the exceptionally prosperous conditions of 1924-25 and 1925-26 and that better times were sure soon to follow. The question that suggests itself here is, was not the financial policy of Government itself animated by a kind of feeling that the prosperity of those years was going to continue, that trade and industry had adjusted themselves to the world conditions of the times, that incomes and savings of the people would continue on the same scale and that Government would be able, with ease, to tap these resources through taxation and public loans, and did not Government and the Currency Commission make light of the objection of the opponents of the 18*d*. ratio that Indian wages, industrial costs and the general cost of living had not yet adjusted themselves to the fall in prices and that a further decline in the price level, if it was not prevented by means of a lower rate of exchange, would have a detrimental effect upon industry and trade and the financial position of the Government? A careful review of the facts leaves little doubt on one's mind that the Finance Member himself, in his budget speech of 1930, perhaps unconsciously, nevertheless with remarkable accuracy and insight, placed his finger on the real dark spot when he declared: "We have been working, in the past three years, with a

dangerously low margin." Government's revenue and expenditure had been indeed balanced and surpluses had been realised, but who ever paused to consider whether these results had not been attained by putting the country's resources to an inordinate strain and by robbing the national economic and financial system of all its elasticity? Repercussions of a world-wide depression on India could certainly have not been avoided, but they could, in all probability, have been faced with less difficulty if our resources had been more carefully conserved in the earlier years. As it ultimately turned out, the illusion of the easy optimism of the era of fleeting prosperity was shattered by the storm of the world depression and political distrust and agitation which have characterised the history of the last three years.

5. *World Economic Crisis.*—No sensible and fair-minded critic would assert that the Government of India ought to have managed their finances in such a way that the country could have altogether escaped the depressing effect of the economic crisis that overtook the world two years ago; and it is not surprising that the Indian Finance Member should have attributed his troubles mainly to disturbed economic conditions in and outside India. In recent years, a vast literature has appeared, dealing with the subject of the prevailing crisis as a world phenomenon, and every thinker and businessman has given his own diagnosis and prescription. We referred to this topic in an earlier Chapter, and it is not necessary to discuss it at length here again. It will suffice if we make a few observations, particularly with a view to indicate the bearing of the world crisis on the financial and economic conditions prevailing in India at the close of the last decade. The main question pertinent to our present enquiry is, (the world depression, of course, lying beyond our control,) in what state were our national finances when they were caught in the storm and how has Government steered the course of the ship of its financial management? After the close of the Great War, it took the nations of the world a few years to clear the wreckage and repair the damage caused by the catastrophe. It was found that the burdens of national debts were heavy, that international trade had been disorganised, that currencies and exchanges had been thrown into disorder every where and that national budgets could not be balanced. This was a state of affairs too dangerous to be allowed to continue, and determined efforts were made to bring some order out of the prevailing chaos. One of the most striking features of modern economic organisation has been the dependence of the well-being of nations on the undisturbed course of international trade and on the maintenance of international co-operation in the midst of competition, peculiarly characteristic of modern capitalism. The international conference held at Genoa in 1922, therefore, made two important recommendations, both of which were quoted by Sir Basil Blackett in his first budget speech; and these were:—"An essential requisite of the economic reconstruc-

tion of Europe is the achievement by each country of stability in the value of its currency"; and "In each country, the first step towards re-establishing a gold standard would be the balancing of the annual expenditure of the State without the creation of fresh credit unrepresented by new assets. The balancing of the budget is the first consideration." In the course of the next two years, a good deal of success was achieved in both these directions in India as well as in other countries. In our account of the management of India's national finances during the second period of the last decade, we have shown how the rupee was stabilised in relation to gold in 1927 and how the Indian budget was placed beyond the risk of deficits, in spite of the loss of 10 crores of Provincial contributions to the central revenues. Trade depression and unemployment, however, continued in all parts of the world, and it was felt that an effective remedy to bring about an economic revival would be for nations to free trade between country and country from the shackles of protective and restrictive tariffs; and the Geneva Conference of 1927 was convened to consider this question. The disarmament conferences have had a similar motive, *viz.*, to reduce national armaments, the ruinous cost of which hampers economic recovery and which are both a cause and an effect of international distrust.

6. *Superficial and Deeper Causes of the Crisis.*—While these discussions have thrown useful light on the problems confronting the nations of the world and some constructive work has resulted from the suggestions emerging from them, appreciable progress has not been possible owing to a lack of a correct understanding of the fundamental causes of the disease. The famous memorandum of Sir Henry Strackosch and the reports of the Gold Delegation of the League of Nations, have laid special stress upon the accumulation of gold in France and the U.S.A. and the consequent maldistribution of the yellow metal among the central banks of the world, and the consequent narrowing of the basis of credit, as the principal cause of the collapse of prices, trade and industrial stagnation and unemployment. While the influence of the distribution of gold on general economic developments can not be and has not been denied, it must be stated that it has often been exaggerated. What is, however, more important is that the causes of the maldistribution are not sufficiently attended to, though quite recently, the vital and urgent importance of finding a practical solution for the problem of German reparations and inter-allied debts has been recognised as a condition precedent to the economic revival of the world. The fact, however, that world economy has been disorganised owing to the radical changes which the War and the Peace of Versailles have brought about, has not received that consideration which it deserves. For instance, economic revival is identified by many with the restoration of the pre-war order of things by pre-war methods, whereas in the altered

political and economic conditions of the world, it must be nothing less than reconstruction and reorganisation. Intense nationalism, a growing desire for national economic self-sufficiency, increased productive capacity in the field of agriculture as well as of manufacture, alteration in the volume, the composition and the direction of national imports and exports—these constitute a powerful undercurrent in the economic developments in the world, which are also influenced by occasional movements of a comparatively mild character.

7. *How they Operated in India.*—What is now the bearing of this explanation of the causes and the course of the world crisis on the question under discussion? It is this. With the termination of the Great War, an economic cycle began, whose duration has proved inordinately long; or it may be called an economic wave of unusual length, whose movement has taken several years to complete its full course. In the midst of this cycle or wave, subordinate movements have been visible from time to time, and they have created the illusion that the disturbed economic equilibrium was being restored. This was the kind of illusion that led Government in India to believe that in 1928, economic and financial conditions had been brought to a stable equilibrium and that they could confidently look forward to steady progress and continued prosperity. But in reality the financial potentialities of the country had, by that time, been pretty nearly exhausted by high rates of taxation and the lending capacity of the people in India had been dried up by the large and continuous drafts which had been made on it. And when immediately after this, political discontent and uncertainty about the constitutional future, came to be combined with a spell of depression abroad and in this country, the financial organisation was found unequal to the strain. The assumptions relating to the productivity of taxes and the capacity of the public to contribute to Government loans, from year to year, proved to be too sanguine, and the third period of the decade under review was left to make the most of this legacy. The illusion, however, still persisted, as we have shown, to dominate the policy of Government during the period of transition in spite of glimmerings of the reality of the situation.

8. *Statistical Comparison.*—How the delusion dogged the footsteps of the financial policy of Government and how expenditure was maintained at a high level, when the resources available were insufficient and inelastic, may be demonstrated by means of a few comparative statistics :—

REVENUE AND EXPENDITURE AND YIELD OF PRINCIPAL TAXES.

(In Crores of Rupees.)

	Total Revenue.	Total Expenditure.	Surplus or Deficit.	Customs Revenue.	Income-tax Revenue.	Gross Expenditure on Military services.
1923-24 ..	133·1	130·7	+2·3	39·6	18·2	61·0
1924-25 ..	138·0	132·3	+5·6	45·7	16·0	59·6
1925-26 ..	133·3	130·0	+3·3	47·7	15·8	60·3
1926-27 ..	131·7	128·7	+2·9	47·3	15·6	60·9
1927-28 ..	125·0	127·2	—2·2	48·2	15·0	56·3
1928-29 ..	128·2	129·2	—1·0	49·2	16·7	58·4
1929-30 ..	132·6	132·4	+ ·2	51·2	16·7	59·0
1930-31 ..	124·5	136·1	—11·5	46·8	16·0	58·2
1931-32 .. (budget)	134·8	134·8	+·01	56·4	17·4	56·4
1931-32 .. (revised)	120·7	134·4	—13·6	46·2	17·3	55·8
1932-33 .. (budget)	129·9	127·8	+2·1	52·3	18·7	50·9

It will be observed that national expenditure in 1930-31, a year in which general economic depression had become a reality, was higher than in the preceding six years and exceeded the expenditure for the year 1928-29 by nearly seven crores! Even the revised estimate of expenditure for 1931-32 was larger than for any year between 1924-25 and 1929-30. Expenditure on military services was practically the same in the budget for 1931-32 as for the year 1927-28, *viz.*, 56·4 crores. Then the tax on incomes has shown little increase in the yield in spite of additions made in recent years. It was 16·7 for both the years 1928-29 and 1929-30 and there was only a slight increase in the proceeds of the tax in the course of the next two years. Customs revenue reveals a similar tendency, in spite of additions put on the import duties. Customs yielded over 49 crores in 1928-29, over 51 crores next year and were expected to give only 46 crores according to the revised estimate for 1931-32. So much about ordinary revenue and expenditure charged to revenue. It is necessary to emphasise that in the two years 1927-28 and 1928-29, there were actual deficits and the gap was filled by drawing upon the realised surplus of 1926-27 which was credited to the "Revenue Reserve Fund" in 1927. And yet Provincial contributions were wiped out in the fond belief that a permanent surplus has been attained. The position of the above Fund was as follows:—

	Transactions.	Closing Balance.
1926-27 ..	+2·9 crores	2·9 crores
1927-28 ..	—2·2 "	0·7 "
1928-29 ..	—0·7 "	..
1929-30 ..	..	..

9. *Capital Outlay and Public Borrowing.*—If we turn to the position as regards the public debt and railway finance and try to ascertain whether the pace of progress set in the second period, was either kept up or could be kept up, the conclusion appears to be irresistible that here also, as in the matter of current expenditure, Government had been living beyond the country's means. When national finances began to feel the severe strain of the growing economic depression in 1930 and 1931, it seems to have dawned upon Government that it had been working on a very low margin and that it could no longer meet its normal expenditure in spite of the high level at which taxation was being maintained. The position with respect to capital expediture, public debt and railway finance, affords ample evidence of this fact; and there could now be no doubt that the fleeting financial flutter of the earlier years had been delusive and a gamble in an uncertain future. "Lay out funds liberally on productive enterprise" and "find the requisite money in India itself," used to be Sir Basil Blackett's exhortation. His optimism is fully reflected in his last budget speech, in which he expressed the hope that his capital policy would be continued successfully in the coming years. He said:—"It is, in my opinion, well worth India's while to persist in the policy of spending money freely on capital development for productive purposes. The railway budget introduced last week, with its big reductions in fares and freights, is evidence of the value of the policy we have been following." The aggregate capital expenditure, including 24 crores for the ordinary railway programme and 4 crores for the purchase of the Burma railways, was calculated for 1928-29 at 40 crores while the net amount of debt falling due for discharge would be 19 crores. Allowing for other capital resources available, it was expected that it would be sufficient to raise a loan of about 32 crores only, of which about 13 crores would represent new money; and no difficulty was anticipated as regards the raising of this money in India.

Now, what is the picture which greets our eyes when we look at the situation in 1929? Even before the world-wide economic depression had asserted itself, the machinery of national finance had begun to betray signs of the strain it was feeling. It fell to the lot of Sir George Schuster to discover the creaking of the machine in the very first year of his administration, and he gave an instructive review of the position in his budget speech of 1929. The figures he gave, are worth quoting. Between 1st April, 1923 and 31st March, 1928, Government undertook capital expenditure amounting to about Rs. 120 crores and roughly £50 millions. Of this, only Rs. 12 crores and £13 million formed the net proceeds of public loans, the balance of no less than Rs. 108 crores and £36 million, being provided from other sources. Of the total, Rs. 69 crores and £49 millions were for railways. The main sources which fed the large amount of capital expenditure were the following:—Post Office cash certificates and savings bank deposits=37 crores; other savings bank deposits=19 crores; provision for reduction and avoidance of debt=22 crores; depreciation and reserve funds=25 crores; reduction in opening cash balance in India =16 crores; revenue surpluses=12 crores. Together with some smaller items, we thus have a total of 152 crores and it was out of this amount that the above mentioned 108 crores were found, and the balance of £36 million was met by the remittance of the surplus of Rs. 44 crores remaining, with the addition of £4 million from the sterling balances. The Finance Member put it mildly when he concluded from a review of these figures that the resources which had been relied on in the course of the preceding few years, would not be available in the same measure in the future, and he gave the following reasons for arriving at that conclusion:—"Government balances had been reduced to the lowest reasonable level; budget surpluses for the future can hardly be counted on to the same extent; the sale of cash certificates shows a progressive diminution year by year, though as far as this is concerned, the result does not necessarily indicate that the money that was provided through this channel may not be available for investment in Government securities in some other form, now that the yield on such other securities has improved relatively to that on cash certificates." The question of the use of railway reserves and depreciation funds and of the maintenance of those funds on the existing scale, was a matter of larger policy connected very closely with the question of the railway convention based on the separation of railway finance from the general finances of the country. It followed as a consequence that Government had to be prepared now to raise a larger proportion of their capital expenditure in the form of public loans and to limit that expenditure by the possibilities of the money market. Briefly, Government's motto had to be, as the Finance Member put it, enterprise combined with caution or enthusiasm tempered with self-control. Masterly inactivity would be a more appropriate expression according to critics of Government policy.

10. *Drastic Cut in Railway Capital Expenditure.*—The Finance Member's summing up of the situation which has been already quoted, affords a remarkable demonstration of the truth of the conclusion we have drawn from our study of the conditions that obtained and the policy Government followed with reference to them, *viz.*, that national expenditure, taxation and capital outlay during the years 1924-25 to 1928-29 were on such a high scale that they outstripped the limited economic capacity of the country; and consequently, when bad times came, there were no reserve powers on which Government could draw for meeting emergencies. During those six years, tempted by a short-lived revival, Government set up a standard of living which was far in excess of its own and the country's normal earning capacity; and the fate which befell its finances was the same as overtakes an individual who spends without foresight and pledges the future to meet current outgoings. By anticipating developments a little, we may state that capital expenditure on railways was severely cut down during 1930-31 and 1931-32; and for the next year, it practically came to a standstill, when it is remembered that outlay on works in hand and on urgent works could not be avoided. It was thus an irony of fate that precisely when owing to economic depression and widely prevailing unemployment, a vigorous public works policy should have been pursued by Government, it found itself forced to stop the financing of improvements and new works. The latest figures in this connection are most illuminating. Railway capital outlay for 1931-32 is now estimated at 8·3 crores as against 11·4 crores provided in the budget for the year. It was anticipated that a surplus of 1·2 crores, with 4·1 crores taken out of the Railway Reserve Fund, would make up the full figure of Rs. 5·3 crores, the amount of the railway contribution. The working of the railways, however, showed a deficit of about 9½ crores, which had to be made good by means of a draft on the reserve and depreciation funds. There is a drastic cut in railway capital expenditure for 1932-33, the proposed provision being only Rs. 4·1 crores as against 29·3 crores for 1928-29, 30·1 crores for 1929-30 and 8·3 crores for the year 1931-32!

The Railway Convention.—Now that in accordance with the separation convention which Sir Basil Blackett once described as one of the greatest achievements in the realm of Indian finance, Indian railways are looked upon not as ordinary Government departments whose incomings and outgoings are merged in the general national finances but as independent commercial concerns which are expected to earn enough to pay interest on borrowed capital and also to build up a reserve and a depreciation fund by annual contributions out of earnings. Let us see how our Railways stand in this respect to-day, in view of the intimate relation that subsists between their financial position and the general prospect of national finance, even in spite of the technical separation of the two. It will be useful, for this purpose, to follow the Commerce Member in the Government of India in the review he presented in his budget speech this year in the Legislative Assembly. The years between 1922-23 and 1929-30 were years of surpluses out of which substantial contributions could be made in aid of general revenues. But in the three years from 1930-31 onwards, there have been deficits, ascertained or estimated, amounting to 3, 7½ and 5½ crores. This position may be looked at from two different points of view. According to the first view, the railways have failed to provide the full sum required to be set aside if the future is to be safeguarded and our ability ensured to meet fully out of accumulated revenues all sums required for replacements in the future." This state of things is not unlike the practice of commercial concerns to regulate "allocations to depreciation in any particular year, not on theoretical grounds but on the basis of the actual results of the year's working." In the second view, on the analogy of ordinary companies which raise their capital in the shape partly of debentures, with their priority of charges and partly of shares and which, in times of difficulty, have to sacrifice the dividend first, provision for depreciation next and prior charges last of all, Indian railways, whose capital has been almost wholly raised in the shape of debentures, have no dividend to sacrifice and must postpone making adequate provision for depreciation and pay off interest on borrowed capital in full. How the Commerce Member wished that only a fourth of the capital of the Indian railways had been in the form of ordinary shares instead of in the form of fixed interest-bearing securities, so that it would have been possible, "in each of the three deficit years, to meet the depreciation charges in full by means of a reduction in, or the total suspension of the ordinary dividend!" And the consolation he had to offer to the Indian tax-payer was that even when the country was passing through the severest crisis the world had ever seen, what he had to face was "no worse than that which an ordinary commercial undertaking has to grapple with, when all obligatory expenditure can be met in full but dividends on the ordinary shares can not be paid."

11. *What about Railway Contribution?*—But the question remained: what about the railway contribution to general revenues? The Commerce Member was inclined to argue that the railway contribution might be regarded either as a measure of taxation imposed on the railways or as being in the nature of an additional distribution of profits which the tax-payer, in his capacity as the ordinary shareholder of the undertaking, may fairly expect to receive in addition to the recoupment of the interest he himself has to pay on the capital invested in the undertaking. In either case, in the midst of acute economic depression, the tax-payer cannot hope to receive anything from the railways

as they cannot bear the one and cannot spare the other. In 1929-30, the balance in the reserve fund accumulated to about 18½ crores, and it was thought that this amount would be ample enough to tide the railways over three or four years of bad trade, but all such calculations had been utterly falsified by the extraordinary fall in prices and the stagnation of trade which started its destructive career in 1929. Government had to confess to a feeling of helplessness under the blow of the calamitous crisis and had no definite ideas to work out.

Though it is true that the railways could not have escaped the disturbing and detrimental influence of the serious depression of the past three years, one is led to make the same comment on their railway and capital management as the observations we have offered on the policy of Government with reference to general national expenditure, taxation and borrowing. While railway capital expenditure was incurred with a lavish hand, the working expenses and interest charges showed a proportionately greater increase than the gross revenue. Even comparing the two years 1926-27 and 1929-30 we find that while the total receipts were Rs. 98 crores and 103 crores respectively, the total charges were 88·8 crores and 97¼ crores respectively in the same time.

12. *Another Proof.*—Another proof of the exaggerated idea entertained in 1928 of the elasticity and soundness of national finance, is found in the inadequate provision that was made for meeting the liability accruing steadily on the Postal Cash Certificates. The amount payable as interest on these certificates varied from year to year and was less than the amount of the interest that had accrued and might have to be paid at any time in the future. This accrued but undischarged liability was estimated to stand at about 3¾ crores in Ocober, 1927 and about 5½ crores twelve months later. But provision was made each year for actual receipts and disbursements during each official year without any reference to the accrued liability. The Finance Member was conscious of the fact that Government might be called upon to pay the balance of the interest at any moment and that the revenue position in 1928 did not permit any thing being done in the matter. "The liability," he said, "is becoming too large for us to be content to leave the full burden to fall on later years, when a sudden increase may seriously disturb the equilibrium of the budget." This self-complacency is characteristic of Sir Basil Blackett's administration. His successor stated two years later that the balance of the amount of the cash certificates then was about 35 crores and he would have to make a provision of Rs. 1·8 crores for the liability estimated to accrue in 1930-31. And as to the accrued liability which was not included in the above figure, he said:—"I have come to the conclusion that this accrued liability must be regarded now as part of the Government's debt." The consideration of the question of the provision for reduction or avoid-

ance of debt, which was then due, was postponed, to be taken up along with that of the Railway convention.

It is easy enough to see that in the state of national finances described above, Government's position in the money market and also its budget must be seriously affected when the world-wide depression and prevailing political troubles simultaneously exerted their influence on it. Prices of Government securities steadily declined and it had to borrow at high rates of interest. The Finance Member's testimony to the correctness of the view we have repeatedly advanced in this connection, may be quoted here:—"It is clear now in retrospect, that from 1925 to the beginning of 1928, the full effects of the capital expenditure launched by the Government were not felt. Such expenditure as was incurred was met very largely from reserves, while the expenditure itself had not got fully under weigh. When once expenditure got going at the full rate and had to be met not from reserves but by fresh borrowing, it was obvious that the prices of Government securities must come down from the high peak to which they had climbed." It may be recalled that Sir Basil Blackett often spoke with great pride of one striking line of economic and financial development in India and that was the capacity of the people of this country to find all the funds that the State needed for capital expenditure, from year to year. But with depressed trade and industries and with the economic resources of the public dried up by Government's policy relating to expenditure, taxation and currency, it became necessary for his successor to provide for sterling borrowing on a considerable scale in 1930-31 and 1931-32, the amount for the former year being as large as Rs. 35 crores. The position has thus been entirely changed for the worse and it will be interesting to know the view which Government now take of it.

13. *Government's Credit Deteriorates.*—Deterioration in Government credit during the short period of transition as compared with the earlier years, is brought out in the following figures of the market prices of securities, which are too eloquent to need any comment:—

MARKET PRICE ON 20TH FEBRUARY.

(In Rupees and Annas.)

Year,	5% tax-free loan, 1945-55	3½ % loan.
1923 ..	89-8	58-0
1924 ..	97-12	65-14
1925 ..	97-15	66-9
1926 ..	101-4	71-6
1927 ..	107-2	77-7
1928 ..	106-11	76-1
1929 ..	103-15	72-6
1930 ..	100-0	64-1

The view of the Commerce Member about the Railway contribution to general revenues which has been given above, may be instructively compared with the one presented by the Finance Member in his budget speech in 1930 on the same subject. He would regard that contribution, of course, exclusive of the refund of the actual interest which Government themselves have to pay on loans raised for railway purposes, as a percentage on the capital advanced to the Railways. Thus regarded, it represents the distribution of even less than 1¼ per cent. on the Government debt, which forms the basis of the provision for reduction or avoidance of debt. The Finance Member remarked thereon:—"In fact, I think it is, on broad lines, correct to regard the one as balancing the other, and we shall arrive at a truer picture of what the Government draw from the Railways if we realise that, in fact, the Government get no profit but apply practically all that they receive apart from a refund of their own interest payments, for the amortisation of their capital. When, therefore, the contribution falls below a certain figure, the Government, if they made up their accounts on a profit and loss basis, would actually show a net loss on the year." Though this view was urged as a plea in favour of the consideration of the adequacy or otherwise of the provision for the reduction and avoidance of debt along with that of the railway convention, owing to the intimate connection subsisting between the two, it shows a wider vision of national finances than the restricted railway business outlook of the Commerce Member. Reference may be made here, in passing, to an improved method adopted by Sir George Schuster of compiling public debt statistics, in which the total interest-yielding assets of the State were recorded as against its interest-bearing obligations and cash, bullion and securities held on Treasury account, the balance of interest-bearing obligations not covered by the above assets, being separately shown, to give a clear idea of the nation's net liabilities.

The following table exhibits the totals of India's national debt under the chief heads, for a series of years, and shows how the public debt position has deteriorated:—

INTEREST-BEARING OBLIGATIONS OF CENTRAL GOVERNMENT.

(In Crores of Rupees.)

On 31st March.	1923	1925	1927	1929	1930	1931
Interest-bearing obligations in India.	476·4	515·0	553·7	602·7	648·3	643·4
In England at 18*d.* per rupee ..	405·3	454·9	452·4	471·7	488·2	517·0

On 31st March.	1923	1925	1927	1929	1930	1931
Total Interest-bearing obligations ..	881·7	970·0	1006·1	1074·4	1136·5	1160·4
Interest-yielding assets ..	633·0	716·6	786·9	875·5	913·7	937·4
Cash, bullion &c ..	44·8	57·3	37·4	28·3	45·3	29·0
Balance of obligations not covered by above assets ..	203·9	196·0	181·8	170·6	177·4	193·9

Attention may be drawn to the more important features of the figures in the above table and to certain particulars which are not specifically included in it. (1) The total interest-bearing obligations have increased from Rs. 881 crores in 1923 to Rs. 1026 crores in 1928 and Rs. 1160 crores in 1931, the increase in the last three years alone exceeding Rs 134 crores. (2) There were no treasury bills in the hands of the public during the three years, 1925 to 1928, but these amounted in 1930 and in 1931 to Rs. 36 and 45 crores respectively. This is a clear indication of disturbed financial conditions and of the worsening of Government's debt position. (3) Treasury bills in the Paper Currency Reserve, which amounted in value to Rs. 32 and 39 crores in 1928 and in 1929 respectively, dwindled to Rs. 29 and 5 crores in the next two years. This fact has to do with currency deflation and the sale of silver in the Reserve. (4) The total obligations in England amounted to Rs. 405 crores in 1923, to Rs. 459 crores in 1928, to Rs. 488 in 1930 and to Rs. 517 crores in 1931 (sterling being converted throughout at 1*s*. 6*d*. to the rupee). (5) Obligations not covered by assets stood at Rs. 203 crores in 1923, at Rs. 172 crores in 1918, at Rs. 177 crores in 1930 and at Rs. 193 crores in 1931. The significance of the last two items is obvious.

14. *India's "Hoarded" Gold.*—It will be recollected that Sir Basil Blackett laid great stress upon the success of his beneficial policy of basing Government finance, as far as possible, on attracting rupee capital in India, and Sir George Schuster paid a well-deserved tribute to his achievements of stimulating "the fruitful employment of the savings of the Indian public in the development of India's resources." But neither the economic nor the political conditions were, any longer, propitious for the continuance of the policy of restricting Government borrowings to the Indian money market; and Sir George Schuster had to enter on an elaborate defence of the change which had been forced on him. He argued, in effect, that there was nothing inherently wrong in a backward

country borrowing abroad, that even nations like the U.S.A. had done it before the war, with advantage to themselves and that the burden of the external obligations of India was exaggerated. And after all, it was in the hands of the people of India themselves to render sterling borrowing unnecessary. The Finance Member remarked:—"If all the money which now goes to the import of treasure was to be made available for investment in productive undertakings, India's need for foreign capital might well disappear. Even in the forthcoming year, (1929-1930), with a large capital expenditure programme, we need to raise only 18 crores from the public against which may be set the fact that the average net imports of treasure since the War, excluding the abnormally high figures for 1924-1925, have been more than twice as large in value." This way of looking at Indian imports and consumption of gold, involves a misconception as common as the alleged Indian prejudice against external borrowing. The world would not have cared for India's imports of gold if it had not been for the fact that the yellow metal is the foundation of credit and currency in all civilised countries, while in spite of our gold standard, it occupies in our currency and banking system, a very subordinate place. It will be recalled how the Hilton Young Commission, in spite of its desire to establish a visible relation between Indian currency and gold, evinced considerable anxiety over the serious inconveniences which India's proposed adoption of the gold currency standard was, in its opinion, likely to cause to the credit and currency systems of European countries. Self-inerest and inadequate appreciation of the social and economic conditions in this country, on the part of outside observers, are responsible for the unfavourable comment that is usually made on gold consumption in India; and it is unfortunate that even Government officials here are often found to share in the prejudice.

15. *Misconception and Exaggeration.*—It is common ground that on account of the illiteracy, ignorance and general backwardness of the large mass of the population of India, such savings as the people annually make, take the shape, to a considerable extent, of gold and silver ornaments and that it is only with educational and economic progress that a gradual improvement may be expected in this respect. It is, however, difficult to understand why the non-monetary consumption of gold, which passes almost unnoticed in the West, as "use in the arts", should, in India, become "hoarding" which is barbaric, if not barbarous. India's annual import of gold amounts, on the average, barely to one rupee per head of the population, and it is used as a luxury, conventional necessary and a store of value. Gold ornaments serve the double purpose of an article of ordinary ware for the women folk and occasionally for men and children, and as the basis of credit in times of domestic or industrial and commercial financial difficulty. Foreign taste would condemn such use of gold as wasteful, and if the money devoted to its purchase had been spent say, on cigarettes, liquors, gramophones and other

articles yielding momentary pleasure, that method of consumption would probably have been counted as a sure sign of an improved standard of living and of progress! Sir George Schuster was not unaware of this aspect of the problem, and he frankly observed in his budget speech of 1928-29 as follows:—"I fully recognise the difficulties, and that Government can not expect to get the small men all over India to invest their savings except as a result of a steady course of education and the provision of better facilities. This is a matter on which I hope our Banking Enquiry will throw light." That fifty crores of rupees worth of gold came out of Indian stores of value, and was exported in six months, shows that it had been saved to some purpose after all and that it must have stood thousands of persons in good stead in times of dire need. In his enthusiasm for promoting the conversion of India's external debt into an internal debt, and for satisfying all the capital requirements of the country by tapping internal sources, Sir Basil Blackett used to hammer at this subject, which was likewise discussed in his time by the Committee on External Capital. He went so far in his budget speech in 1926 as to join those who attribute India's povery to her "uneconomic tradition which does not recognise the production and accumulation of wealth as being among man's legitimate aims." This expedition into the realms of economic philosophy was hardly necessary and its only significance lay in the fact that the prevailing financial administration of India was ill-adapted to the social and economic condition of the people, being too costly for their means, in any event. While there is, to be sure, some element of ignorance and misunderstanding at the bottom of the popular prejudice against the contraction of external obligations, the opposition is really based upon economic considerations, *e.g.*, its failure to promote indigenous enterprise, the exchange troubles it is apt to create and the fact that the use of external capital is not under Indian control as well as the constitutional and political difficulties it engenders, as experience has amply demonstrated. Though he appreciated the importance of developing the Indian money market and of making full use of it for meeting the country's needs of economic progress, Sir George Schuster's justification of sterling loans was the inexorable requirements of his treasury, which felt the pinch of the prevailing depression.

16. *External Borrowing—Why it became Necessary.*—The problem of sterling loans is bound up, particularly during the years we are here dealing with, *viz.*, 1929 to 1932, with questions relating to (1) the prevailing low level of prices, (2) contraction of currency, (3) flight of capital from India, (4) weakness of exchange, (5) increased floating debt in the country, and (6) the general difficulties of the national exchequer; and a brief account of developments in all these respects will be essential for a clear understanding of the situation as it shaped itself at the close of the decade we have had under review. The bud-

get speeches of the Finance Member during these years, may be read with profit as they will be found to elucidate in a simple manner the complexities of the financial tangle. In his budget speech of 1930, Sir George Schuster summed up public criticism of Government currency policy under four heads, *viz.*, that it (1) created a shortage of currency in the country, producing a fall in prices; (2) resulted in the Government incurring a heavy floating debt, with serious loss to revenue; (3) it increased the difficulties of the business world by the artificial creation of dear money; and (4) it reacted on the credit of India and led to costly sterling borrowing. Having explained the peculiar responsibility thrown on Government by the double role they have to play, *viz.*, as (*i*) the currency authority and (*ii*) operators in the exchange market, he pointed out that Indian prices being largely governed by world prices, with a fall in their level, currency has to be contracted to avoid an inflationary position and that the contraction actually effected was by no means excessive. When currency is contracted, Government lose the profit to be derived from the issue of currency. The amount of treasury bills held in the currency reserve is also reduced as a consequence, which means loss of profit in the shape of discount on the bills and on the other hand, discount has to be paid to the public for the bills sold to them. In 1930-31, in spite of a fairly favourable balance of trade, difficulty was experienced in making remittances to London owing to the flight of capital out of the country, due to political and economic uncertainty. To support the sagging exchange, whose weakness resulted from this cause, Government, as currency authority, had to take measures to maintain the value of the currency,—"measures designed, on the one hand, to make it difficult to obtain rupees for conversion into foreign currency and to make it attractive for foreign funds to seek employment in India." That is to say, interest rates were maintained at levels higher than would otherwise be necessary and surplus funds were drawn off the market by the issue of treasury bills at expensive rates. Owing to weakness of exchange, only a little over £5 million sterling could be purchased in the market in India in 1930-31, and nearly an equal amount of sterling had to be sold; and the Secretary of State's requirements had to be met by other means such as remittance through Paper Currency Reserve and borrowing in London. There were, therefore, three sterling issues during the year, totalling £31 millions. Temporary advances had, in addition, to be taken from the London branch of the Imperial Bank of India, to the extent of £6 million, and of this, only £2 million could be returned before the end of the year. The entire holding of the Currency Reserve in England, amounting to about £2½ million and sterling securities in the Gold Standard Reserve for 6¼ millions were transferred to the Indian treasury.

17. *Illustrative Statistics.*—Statistics to illustrate the developments and operations described above, are given below:—

I

INDEX NUMBERS OF PRICES.

(Wholesale)

	Calcutta.	Bombay.	United Kingdom
1927 ..	148	147	141
1928 ..	145	146	140
1929 ..	141	145	137
1930 (April) ..	123	134	124
1930 (Sept.) ..	111	120	116
1930 (Decr.) ..	101	110	109
1931 (March) ..	100	111	106
1931 (Sept.) ..	91	..	99
1931 (Decr.) ..	98	..	105

INDIAN INDEX NUMBERS.

	Exported articles.	Imported articles.
1929 (Sept.) ..	217	167
1930 (Decr.) ..	138	141
1931 (Jan.) ..	137	133
1931 (July) ..	119	151
1931 (Decr.) ..	123	..
Fall in Sept. 1931 as compared with Sept. 1929 ..	47	17
Fall in Decr. 1931 ..	43	10

CALCUTTA INDEX NUMBERS.

Fall in Sept. 1931 as compared with Sept. 1929 ..	47	20
Fall in Decr. 1931 ..	30	17

II

BALANCE OF TRADE.

(In Crores of Rupees.)

	1928-29	1929-30	1930-31
Balance of Trade in Merchandise (Private) ..	+86·4	+78·9	+61·9
Balance of Transactions in Treasure (Private) ..	—34·3	—26·2	—24·4
Total Visible Balance ..	+52·1	+52·7	+37·5
Purchase of Sterling in India, etc. ..	—41·0	—20·3	—7·2
Sterling Transfers on London sold in India ..	..	..	+7·7
Balance of remittance of Funds.	—41·3	—21·0	—0·08

III

COMPOSITION OF PAPER CURRENCY RESERVE.

(In Crores of Rupees.)

	Gross circulation	Silver coin in India	Gold coin and bullion in India	Silver bullion in India	Sterling securities in England.	Rupee securities in India	Internal bills of exchange
March 1928 ..	184·8	98·7	29·7	7·6	3·7	37·9	7·0
Sept. 1928 ..	184·6	104·0	29·7	2·8	5·6	42·3	..
Dec. 1928 ..	189·0	96·1	31·1	4·6	6·8	43·2	7·0
March 1929 ..	188·0	94·9	32·2	4·9	10·6	43·2	2·0
Sept. 1929 ..	186·8	108·0	32·2	4·9	2·4	39·1	..
Dec. 1929 ..	179·4	103·7	32·2	4·2	1·8	37·3	..
March 1930 ..	177·2	108·1	32·2	2·8	0·1	33·8	..
Sept. 1930 ..	171·4	115·9	32·2	5·8	1·8	15·5	..
Dec. 1930 ..	161·3	114·6	31·7	5·3	..	9·6	..
March 1931 ..	160·8	117·8	25·8	6·9	..	10·1	..

IV

ABSORPTION OF CURRENCY.

(In Crores of Rupees.)

	Rupees	Notes	Total
1927-1928 ..	—3·7	10·2	6·4
1928-1929 ..	—3·0	3·5	0·5
1929-1930 ..	—21·7	—18·8	—40·5
1930-1931 ..	—21·5	—11·2	—32·7

CHAPTER VI.

THE STORM BURSTS—CONCLUSION, RETROSPECT AND PROSPECT.

1. *Falling Prices and Trade.*—The storm which had been slowly gathering strength, at last burst in its full fury in 1931-32; and the true significance of the facts and figures quoted and the tendencies indicated in the last Chapter, was clearly brought out by the budget estimates for 1932-33. That the provision made in the budget for 1931-32 for increased revenue, was found to be insufficient and additional taxation had to be imposed in the middle of the year, the new arrangement being made for eighteen months, is sufficient proof of the wretched plight to which national finances had been reduced. This sorry state of things was attributed mainly to (*i*) bad world conditions and (*ii*) internal political troubles; and while giving a technical explanation of Government's technical financial operations, the Finance Member assured the opposition in the Legislative Assembly that they could not have acted differently in the peculiar circumstances if they had occupied the official benches. Even admitting the half-truth contained in this statement of the case, one is entitled to ask whether the results would not have turned out to be less unfavourable if the financial measures of Government had been more in keeping with the real economic conditions and requirements of the country and had been directed in consonance with public opinion. Administration of national finances, though it must be entirely free from political influence in its technical aspect, cannot be divorced from national policy determined by a popular legislature. While the shortsighted extravagance of earlier years had come to roost, Government, in the beginning, made light of the effects of depression and were reluctant to make necessary adjustments in time, hoping that all would be well soon. They ignored the fact that the earning and tax-paying capacity of the people had been steadily exhausted, and that the disastrous fall in prices since 1929, had made the position serious. The heavy reduction in exports, particularly the fall in the prices of India's staples, which was more steep than that in the prices of imported articles, could not but increase the hardships due to a high level of taxation; and the latter was, consequently, bound to be comparatively unproductive. The following figures and the brief explanatory comments thereon, taken from the "Review of certain main items of trade during the calendar year 1931," compiled by the Department of Commercial Intelligence and Statistics, will be found instructive in this connection. It should be stated that the table below shows

(1) the recorded values of imports and exports for the years 1930 and 1931, (2) the index numbers of prices of imported and exported articles for 1913, 1930 and 1931, (3) the value of trade in 1930 and 1931 calculated on the basis of prices in 1913 and (4) the value of trade in 1931 on the basis of the 1930 prices:—

EXTERNAL TRADE AND PRICES.
(In Crores of Rupees.)

	Recorded values		Index Nos. of Indian Prices (1873=100)			Value of trade, eliminating changes in price-level		
	(1)		(2)			(3) Calculated on the basis of 1913		(4) Calculated on the basis of 1930.
	1930	1931	1913	1930	1931	1930	1931	1931.
Imports ..	184·7	135·7	117	152	140	142	112	147
Exports ..	251·7	164·5	154	172	124	225	204	228

"The value of the trade in 1930 and 1931, reduced according to the level of prices in 1913, indicates in some measure, the changes in the volume of trade. It will be seen that the fall in the volume of imports for 1931 as compared with 1930 was 20·4 per cent.; the fall in the volume of exports, on the other hand, was 9·3 per cent. This greater fall in the volume of imports was to be expected. If the value of exports goes down, the value of imports must go down also. As the prices of exports fell much more than the prices of imports, the same volume of exports could only buy a much smaller quantity of imports. The trade figures of 1931, calculated on the 1930 prices, indicate the volume of imports and exports as compared with 1930." The fall in the volume of imports in 1931 as compared with the corresponding volume in 1930 is heavier than the fall in the volume of exports in the former year as compared with the volume of the exports of 1930. This is significant from the economic as well as the political point of view.

2. *Effect of Trade Depression on National Finance.*—The speech of the Finance Member supporting his budget proposals for 1932-33, was a sad recital of depressing events. Though the year 1931-32 was normal as regards agricultural production, Indian exports and imports had fallen in value to a bare half of what they were two years before. Exports of merchandise for the first ten months of 1931-32 amounted to Rs. 134 crores as against Rs. 265 crores for the corresponding period of the preceding year, and the value of merchandise imported, fell from Rs. 201 crores to Rs. 105 crores. The chief contributors to the decline

shown by these "staggering figures," were exports of jute and jute products which fell from Rs. 69 to Rs. 28½ crores and of raw cotton which fell from Rs. 51 to 20½ crores. On the import side, cotton manufactures came down from about Rs. 50 crores to about Rs. 16 crores and sugar registered a fall from Rs. 13·8 crores to about Rs. 5 crores. In spite of this enormous fall, it is interesting to note, the favourable balance of trade, inclusive of the movements of treasure, for the first ten months of 1931-32 amounted to Rs. 71 crores as compared with Rs. 45 crores for the corresponding months of the previous year. The abnormal exports of gold which started in September, were mainly responsible for this phenomenon. An indication that the limits of taxation had been reached and that it had begun to yield diminishing returns, we have the fact that Government collected during the first ten months of the last financial year, *viz.*, 1931-32, Rs. 29 crores of import duties on Rs. 105 crores of imports, as compared with about Rs. 33 crores of duties on Rs. 201 crores of imports for 1929-30.

The scope of our survey does not require us to discuss the provisions of the budget for 1932-33 and we refer to them here to indicate the general tendency of financial developments, at the close of the decade of our review. With the additional taxes authorised in September, 1931, and with reductions in expenditure undertaken as special measures of retrenchment, the Finance Member hoped to secure a surplus of a little over Rs. 2 crores for 1931-32 and 1932-33 combined. Civil charges and military expenditure were both to be subjected to cuts and a saving of about Rs. 8 crores was to be effected; and increases in the yield of taxes like salt and income-taxes, were expected to offset reductions elsewhere. No railway contribution was counted on either for 1931-32 or for 1932-33. The roping in of incomes between Rs. 1,000 and Rs. 2,000 and the surcharge of 12½ per cent. and 25 per cent. respectively in the two years, on all rates of income-tax and supertax, were calculated to contribute to improvement in revenue. The position for the two years is summarised in the following figures:—

I.

BUDGETS FOR 1931-32 AND 1932-33.

(In Crores of Rupees.)

	Revenue	Expen-diture	Surplus (+) and deficit (—)	Proposed reduction in normal provision for reduction or avoidance of debt.	Final Surplus (+) or Deficit (—)
Original Budget, 1931-32 ..	134·8	134·8	+·01	..	+·01
Supplementary Budget, 1931-32 ..	126·1	136·3	—10·1	2·4	—7·7
Budget, 1932-33 ..	133·0	127·8	+5·2	2·4	+7·7

II.

(In Crores of Rupees.)

	Supplementary Budget, 1932—33	Budget, 1932—33
Gross Revenue ..	133·0	129·0
Gross Expenditure ..	127·8	127·8
Surplus ..	+5·2	+2·1

3. *Indian Cotton Mill Industry.*—Analysing the revenue side of his budget, the Finance Member pointed out how the protective duties on the imports of piecegoods and sugar, were having a restrictive effect, which might have been anticipated. With regard to cotton piecegoods, he said in his budget speech:—"To-day we cannot reckon on more than about 900 million yards of imports, as compared with an average of about 1,800 million yards for the post-war period upto 1929, and about 3,200 million yards before the war. It is on the present reduced quantity that we must rely for collecting duties. Taking the post-war years of normal prosperity and post-war prices, say, 1922-23 to 1928-29, the average annual amount of import duties collected on cotton piecegoods was about Rs. 6½ crores. To-day, even with higher duties, we cannot, on the reduced quantities, reckon on a revenue of more than Rs. 3¾ crores." Government have already referred to the Tariff Board for enquiry the question of the necessity of continuing the pre-

sent amount of protection to the Indian cotton mill industry. Whatever the outcome of that enquiry may be, we have to emphasise the recent heavy reduction in the imports of cotton piecegoods as a striking illustration of the radical changes in the structure of world economy, which are responsible for the prevailing crisis. Government appear to have paid scant attention to the economic and political implications of that phenomenon and were disposed to minimise their significance. During the past few years, the pre-war industrial centres and markets have undergone important changes, and manufacturing and trade developments have taken new turns. The following facts and figures taken from a useful little publication, "Statistics relating to Production in the Cotton Piece-Goods Industry," compiled by the Department of Commercial Intelligence and Statistics, are extremely suggestive:—

PRODUCTION OF CLOTH IN INDIAN COTTON MILLS.

Year.	Crores of yards.	Year.	Crores of yards.
1913—14	116	1924—25	197
1915—16	144	1925—26	195
1917—18	161	1926—27	226
1919—20	164	1927—28	236
1921—22	173	1928—29	189
1922—23	172	1929—30	242
1923—24	170	1930—31	256

The conclusions drawn from the above figures, are the following:— "(*a*) Production in the cotton mill industry in India has gone on increasing generally during the whole period examined, *i.e.,* from the beginning of the century upto 1931. (*b*) From a period of comparatively low production between 1921 and 1925 the industry in India has changed over to one of relatively high production. This is the position in the industry at the present moment. (*c*) While textile production in other important countries has fallen very considerably during the last two years the same statement cannot be made regarding India where the production has *actually increased largely* during that period." It is true that the phenomenal fall in the imports of cotton piecegoods may be attributed to the lowered purchasing power of the people, but it is undoubted, at the same time, that decrease in imports has been counterbalanced by a considerable increase in Indian production. High import duties, the abolition of the excise and the increased consumption of home-made goods are mainly responsible for the change, which is also reflected in the comparatively smaller decrease in Japanese imports as compared with the imports from the United Kingdom. There is little prospect of India's foreign trade in cotton piecegoods reverting to the old position unless the above factors undergo important modifications. The result of the impending Tariff Board enquiry, the decisions of the Ottawa and the Round Table Conferences and the trend of public opinion in and outside the Indian Legislature, will largely determine the economic and the financial future in regard to this whole question. An automatic rehabilitation is out of the question.

4. *Taxation of Luxuries and Necessaries.*—Sugar imports into India averaged about 8½ lakhs of tons per annum for a number of years but in 1931-32, only a little over one-half of this quantity was imported and the estimate for 1932-33 did not exceed 5 lakhs of tons. The decreased imports were not attributed to high prices, induced by a high scale of customs duties, since the average wholesale price of sugar did not appreciably rise owing to that cause and was almost steady for three years, as may be seen from the following figures:—

AVERAGE WHOLESALE PRICE OF SUGAR.

Rupees per Ton.

1926—27 ..	312	1929—30 ..	258
1927—28 ..	289	1930—31 ..	237
1928—29 ..	273	1931—32 .. (first half of year)	255

In support of his conclusion that "it is a falling off in purchasing power and not any rise in the price of sugar brought about by our increased duties which has mainly affected consumption," the Finance Member adduced the fact that whereas for the five years from 1926-27 to 1930-31, the average amount of cash spent on the imports of sugar, including the duty, averaged about Rs. 23 crores, it was calculated that for 1931-32 and 1932-33, the corresponding amount would only be about Rs. 12¾ crores and Rs. 14½ crores respectively. With the increased duty, the consumption of silver was expected to show a similar decrease. The policy of tariff protection applied to the Indian sugar industry, it was calculated, would increase indigenous production by about 60,000 tons per annum, and as there would be a corresponding reduction in the imports, public revenues would lose about Rs. 1 crore annually. In order that Government may recoup loss of revenue thus entailed, the Finance Member suggested:—"It is also important to realise that if the Central Government is to have properly balanced machinery of taxation at its command, it ought to have means, either through the income-tax or in other ways, of recovering to itself some increase in revenue to counterbalance the loss which may occur in the revenue from import duties as a result of a protective policy. That is a point which those who are framing a new federal constitution should bear in mind."

While the above articles, which may be classed as comforts and luxuries in India and to the list of which, liquors, tobacco and motor cars may be added, showed a decrease in the volume of import and consumption and in the customs duties levied on them, substantial increases were yielded by taxes on necessaries of life—articles of consumption by the masses; and the Finance Member, therefore, turned hopefully to them. For instance, he regarded kerosene as a reserve since he expected to get from it, in 1931-32, from excise and import duties combined, nearly Rs. 3½ crores as compared with an average Rs. 2¾ crores for the years 1928-29 to 1930-31. It was similarly anticipated that a higher duty on salt had no effect on the consumption, and the enhancement of 25 per cent. in the duty was expected to yield over Rs. 1½ crores, in addition to the normal revenue at the old rate. The same consideration applied to betel nuts and spices. From a review of the comparative consumption of different classes of articles and yield of taxation accruing from them, illustrated by the figures quoted above, the Finance Member drew the conclusion that "if in times of emergency he needs to raise extra revenue, then his most sure and reliable course is to impose slight increases in the taxes which fall on the masses of the population." He went on to observe:—"A few annas per head from 300 millions is the most effective course, whereas attempts to extract heavy taxation from a limited class seem almost to have reached their limit. This is a conclusion which is not likely to be popular, but all who share in the responsibility for maintaining the financial position of India must face hard facts."

5. *Why was Pressure of Taxation increased?*—This is a revelation of the desperate state of national finance, and the statement not only lays down an important principle of taxation but makes an interesting declaration of official financial policy and as such, deserves to be carefully noted. The Finance Member indeed explained that while he took a heavy toll of the limited earning capacity of the mass of the population, he had not omitted to levy a substantially large contribution upon the richer classes, through material increases in the rates of the income-tax, which yielded even in the times of acute depression, as much as 18¾ crores as compared with an average of about Rs. 16 crores for the five years of comparative prosperity from 1923 to 1928. The implication of the statement that all classes of the population were subjected to the burden of taxation with impartial severity, is not calculated to carry much consolation to people who have to pay more even for necessaries of life while suffering continuously from an unprecedented

depression. Much less can it be a convincing defence of the wisdom of Government's financial policy of the preceding few years. Government's consciousness of this aspect of the situation is betrayed by the need the Finance Member felt to enter on an elaborate explanation and defence of his policy in relation to taxation, in his budget speech of 1932. The question that he asked and attempted to answer, was, why had Government to increase the pressure of taxation so severely on the people? And the answer takes us once more to the consideration of the comparative merits of the financial administration of the Blackett period, and affords convincing vindication of the views we have advanced on that subject in the preceding Chapters.

Government's income consists of two main sources, *viz.*, tax revenue and non-tax receipts, and the pressure of the incidence of taxation at the close of our decade can be measured by the fact that "whereas in the comparatively prosperous five years from 1923-24 to 1927-28 the extent to which the Government had to rely on tax revenue (less cost of collection) amounted only to an average figure of about Rs. 67¾ crores, we are endeavouring for 1932-33 in a period of unexampled depression to raise from tax revenue about Rs. 77 crores." Government was driven to apply this pressure because the other, *viz.*, the non-tax sources of income, failed it very badly. These last averaged Rs. 28 crores in the Blackett period, whereas in 1931 and 1932, they were expected to yield only Rs. 9 crores—a drop of no less than Rs. 19 crores. The following table brings out this contrast:—

NET REVENUE AND EXPENDITURE.

(In Crores of Rupees.)

Year.	Tax Revenue less cost of collection.	Other net Revenue.	Total net Revenue.	Total expenditure charged to Revenue.	Surplus (+) Deficit (—)
1923—24 ..	66·6	34·0	100·6	98·3	+2·3
1924—25 ..	67·5	31·9	99·4	93·7	+5·6
1925—26 ..	68·1	28·1	96·2	92·9	+3·3
1926—27 ..	67·9	27·0	95·0	92·0	+2·9
1927—28 ..	68·1	19·1	87·3	89·5	—2·2
1928—29 ..	71·6	16·8	88·5	89·5	—1·0
1929—30 ..	71·7	20·6	92·4	92·1	+0·2
1930—31 ..	66·5	15·3	81·8	93·4	—11·5

Year.	Tax Revenue less cost of collection.	Other net Revenue.	Total net Revenue.	Total expenditure charged to Revenue.	Surplus(+) Deficit (—)
1931—32, (Revised) ..	68·9	8·7	77·7	91·3	—13·6
1932—33, (Budget) ..	76·9	9·2	86·2	84·0	+2·1

6. *Results of Ill-adjusted Policy.*—Apart from the loss of Rs. 9 crores of Provincial contributions, there was deterioration on the three heads, (*a*) net revenue from commercial departments, (*b*) finance heads, and (*c*) opium receipts. Then, military charges remained almost steady in the neighbourhood of Rs. 55 crores whereas the amount provided for meeting the liability as regards Postal Cash Certificates increased from Rs. 23 lakhs in 1927-28 to Rs. 2·2 crores, though the mean capital outstanding increased from about Rs. 29 crores to about Rs. 47 crores. To meet the situation, controllable expenditure, by which is meant military expenditure and all civil expenditure, other than debt services, extraordinary expenditure and the cost of tax collection, was reduced from about Rs. 76 crores, the average of the five years, 1923-1928, to Rs. 64 crores, and tax revenue, which averaged about Rs. 68 crores, was raised to the neighbourhood of about Rs. 77 crores in the budget for 1932-33. The Finance Member concluded with respect to this development that "the need for increasing tax revenue has been brought upon us not by swollen expenditure but by the tremendous drop in the returns from the economic activities of the Government and in the economic productivity of the country on which the revenue from taxation depends." When the realities of the situation, as indicated by the Finance Member, are carefully studied in accordance with his recommendation, what is the impression left on one's mind? Even after making adequate allowance for the difficulties created by the world depression, one cannot but feel that the financial administration of India had not been directed, during and since the close of the Great War, in full accordance with the economic and other conditions and needs of the country and that instead of being cautious, it had been too optimistic and sanguine for the resources of the people. Vascillating between moods of elation and depression, Government's financial policy was ever out of touch with the real possibilities and requirements of the population of the country and it had rarely the good fortune of receiving the support of public opinion, with the inevitable result that financial equilibrium was hard to attain. It need not be repeated that all those

features of successful financial management on which Government prided itself in the time of Sir Basil Blackett, disappeared in three years' time and it reverted to the unsatisfactory condition of the early years of the last decade.

7. *Effects Illustrated.*—Look at it from any point of view you like, and the financial machinery of India appears to be full of instability and uncertainty at the moment. Revenue and expenditure, taxation and tariffs, currency and exchange, railway finance and public borrowing, all share this characteristic, and solutions of vital questions of national financial policy are made to hang on the decisions of His Majesty's Government, pertaining to the pending constitutional developments. In the meanwhile, the Government of India has to carry on as well as it may. From the detailed account and illustrative statistics given in this and the preceding Chapters, a sufficiently clear idea will have been obtained of the state of India's finances, in their various aspects, referred to above, at the close of the decade which we undertook to survey and of the general trend of events as they are likely to shape themselves in the near future. It will suffice to mention a few more facts here. The total public debt of India or the national interest-bearing obligations on 31st March, 1932, reached the record figure of Rs. 1,212 crores and compared with Rs. 1,026 and Rs. 1,136 crores in 1928 and 1930 respectively. The unproductive debt or the balance of total interest-bearing obligations not covered by assets, was Rs. 215 crores in 1932, Rs. 177 crores in 1930, Rs. 172 crores in 1928 and nearly Rs. 205 crores in 1924, the last being the previous record in the decade. The net interest charges amounted, in 1932, to over 13 crores as compared with Rs. 11 crores, the average annual figure for the five years, 1926-27 to 1930-31. Government's approximate borrowing rate, which was 6 per cent. in 1923-24, declined to 4¾ per cent. in 1927-28 and rose again to 6½ per cent. in 1930-31. The balance on account of Postal Cash Certificates stood at Rs. 35 crores in 1929-30 and it rose to Rs. 44½ crores in 1931-32 and was expected to increase to Rs. 49½ crores in 1932-33. The provision out of revenue for the payment of bonus on the Certificates, amounted to only Rs. 23 lakhs in 1927-28, Rs. 73 lakhs in 1929-30 and to over Rs. 2 crores in 1931-32. The sums similarly provided on account of appropriation for Reduction or Avoidance of debt, were Rs. 5 crores for 1927-28, Rs. 5·7 crores for 1929-30 and Rs. 6·8 crores for 1931-32. The balance of treasury bills in the hands of the public stood at Rs. 55·3 crores on 31st March, 1931 and on the same date in 1932 and was expected to amount to Rs. 47·8 crores on 31st March, 1933. The amount of the bills in the Paper Currency Reserve, which was only Rs. 5·8 crores on 31st March, 1931, rose to Rs. 49·2 crores on the same date in 1932, and no change in that position was anticipated at the close of the next year.

8. *Exchange and Currency Once More.*—The Finance Member had a good deal to say on the question of currency contraction and expansion, illustrated by these last figures, in his budget speech in 1932. Government had been criticised for having contracted currency in order to support exchange, in 1930-31, to the inconvenience of trade; and now its policy of currency expansion was also adversely commented on in 1931-32. The charge the Government had to meet was that "the recent expansion of currency is not justified by any rise in rupee prices and that Government is in effect using the note printing press to meet its own requirements, thereby causing a dangerous inflationary position." The Finance Member protested that Government's currency policy was not dictated by revenue considerations, and that its difficulty lay in the fact that it had a dual role to fill and to be the currency authority as well. It had not, however, expanded currency beyond the needs of the public, and if it had done so, its effect would undoubtedly have been reflected in the exchange position, which, as a matter of fact, had not weakened. The relation between exchange, currency, remittances to the London treasury, rupee and sterling borrowing and Government's revenue and capital requirements, is so intimate and the suspicion in the Indian public mind about the exercise by the Secretary of State for India, of his overriding authority in matters economic and financial, is so deep-rooted, that the Government of India cannot expect to escape adverse criticism of its measures and policy in this connection. Let us consider what happened in 1931-32. During the first half of the year, exchange was very weak, and instead of being able to purchase sterling, Government had to sell sterling to the extent of £14 million, and that amount was found by drawing on the securities in the reserves, £9 million more being found from the same source for meeting the ordinary requirements of the London treasury. With the suspension of the gold standard in September, 1931, conditions became favourable and purchases of sterling on a large scale became possible, these transactions being estimated for the year at 35¼ millions.

9. *Latest Developments in that Sphere.*—During a year and a half preceding September 1931, revenue continuously fell short of actual outgoings, and floating debt had to be resorted to on a large scale. At the same time, as currency authority, Government had to draw off the market surplus currency in order to maintain stability of exchange. This process reacted adversely on the budgetary position, and according to the Finance Member, "made the deterioration in our general financial position appear far greater than was really the case". With the turn in the wheel of fortune, after September, 1931, improvement in Government's position as currency authority, had a favourable influence both on its general financial position and its budgetary equilibrium. The Finance Member's comment on this ran: "But we are really doing no more than recovering a part of the ground that we

lost last year, and we have not created a single pie of currency beyond what the public requires." Expansion of currency during 1931-32, provided Government with net additional funds of Rs. 35 crores and the contraction in the two preceding years had amounted to Rs. 43½ crores so that in the three ears, taken together, in performing its duty as currency authority, Government had to lose resources of Rs. 8½ crores. Government was pleased with the beneficial effects of its policy on its own financial position as well as that of commerce and industry which received the currency they needed, the bank rate being reduced from 8 to 6 per cent., at the same time. As we have repeatedly observed, such questions of technical management of financial affairs must be considered not in isolation but in association with larger problems of national economic policy, *e.g.*, the monetary standard, the position of gold in our currency system and the development of the trade and industries of the country. Sir George Schuster essayed to take such a view of the abnormal exports of gold from India and attempted to show how that phenomenon was one phase in a process of many years and how it was an important incident in the course of international trade. Beyond stating that our gold resources were ample, he had, however, not a word to say about the place of gold in the monetary system of India, even as recommended by the Hilton Young Commission. Nor did he declare what Government's attitude was to the question of a Reserve Bank when he reiterated that it played a responsible and a difficult role as national currency authority, even after a special Committee had reported upon India's banking problem. Financial managers in the Government of India, like that Government, as a whole, are mere administrators and are not responsible ministers of State who can formulate and carry out broad national policies. The Finance Member's grievance, therefore, that "our critics often speak as though the interests of Government were somehow different to the interests of the country in this matter", has its origin in this defect in the Government's position. He is perfectly right when he says that "the difficulties of Government, either as the authority for revenue and expenditure, or as currency authority, react on the public and *vice versa*". But that is the very reason why the public wants to have the power of guiding and controlling financial affairs so that the interests of Government and those of the people may be properly reconciled and safeguarded. Here we touch the weakest point in the financial organisation and management of India.

10. *Government's Achievements.*—In a narrow sphere and for the moment, the Finance Member very legitimately expressed satisfaction at the achievements of Government; and they may be recounted in his own words:—"What are the signs at present? We are free from hampering measures of exchange control; exchange is strong; our credit improved; we have reduced our external obligations and strengthened

our reserves, thereby saving the tax-payer interest charges, and improving the chances for raising fresh capital when this is needed for the development of the country; the bank rate has come down from 8 to 6 per cent., and, as a result, all who are engaged in trade and industry have obtained great relief; while as another result, Government securities are rising, a fact, which in its turn is improving the position of all banks and investors. If any one fails to see benefit to the public in all these signs he must be blind indeed." One would not like to deny to Government the satisfaction it derived from the improvement which had taken place in its financial position as a result of the huge gold exports from India and the large remittances of funds it was possible to make to London. Things have to adjust themselves somehow, and one has to make the most of a changing situation. Even the darkest cloud has a silver lining, and Government, like every one else, must extract comfort out of such favourable signs as make their appearance on the horizon. The question of paramount importance for us, however, is, how is the country going to emerge from the economic and financial storm in which it is plunged to-day? How is our whole financial system going to be remodelled in accordance with the country's requirements and conditions? How are old mistakes going to be avoided and new lines of policy going to be laid down? The immediate future is too much shrouded in uncertainty to permit definite answers being given to these questions though the path of reform and the principles of reconstruction are clear beyond doubt and have been indicated in this and the preceding Chapters.

11. *Ground Covered.*—Having now reached the end of our journey, it will be useful if we take a bird's eye view of the road over which we have travelled and attempt to catch a glimpse of the prospect of the near future. Though very tempting, the latter task is extremely difficult. A review of the developments of the past few years is, however, calculated to prove helpful in the understanding of conditions as they prevail at the moment and as they seem likely to shape themselves. And this work has been facilitated by the procedure we have followed in the discussion of the problem to which we set our hand. The selection of the last decade for a study of the events in the history of the national finances of India, though it may appear arbitrary at first sight, has a significance of its own. The opening of the decade is a landmark in the history of Indian finance, first because it introduced an important change in the organisation of the finances of the country, secondly, because it synchronised with the inauguration of certain constitutional reforms, which, though they did not materially affect the powers and the functions of the Central Government, were expected to influence its financial administration and thirdly, because economic conditions in the outside world and in India were dominated by the effects of the

Great War and the hopes and the fears the Peace concluding it, had aroused on all sides. The close of the period has been equally exciting. Further constitutional reforms are tantalisingly in sight, and they give promise of radical changes in financial organisation, though at the moment, Government and people are pre-occupied with several difficult problems of a less fundamental nature, which confront them rather than with what the near future is likely to bring with it. The atmosphere of uncertainty and distrust, political and economic in which national finances are being administered, is most uncongenial to the success of its management. Then, again, economic and political conditions all the world over and in India itself, are as disturbed as they could be; and the closing years of the decade have experienced the full effects of the economic blizzard which has swept over the whole world.

12. *The Three Periods.*—Between such ends lies the decade which we have attempted to study both analytically and synthetically. We saw that it can be conveniently divided into three well-marked periods with peculiarities of their own. During the first period, lying between 1921 and 1924, all energies were directed to rescuing the national finances from the chaos into which they had been thrown by a serious economic depression that came in the wake of a boom, accompanied by huge national expenditure, recurring deficits, heavy additions to taxation and embarrassing exchange fluctuations. Drastic retrenchment in expenditure and the maintenance of a high level of taxation enabled Government to balance its budget and to enter in 1924 upon our second period which lasted for about six years. The first period indeed opened in a disturbed atmosphere, but it was an atmosphere surcharged with cheery hopes of coming economic and financial prosperity. Under the Meston Settlement, the Central Government was consequently saddled with the responsibility of building up annual surpluses that would enable it to remit the Provincial contributions in the course of a few years. Government of India's financial policy in the second period was very largely influenced by the desire to discharge this obligation. The Provinces, in their own financial difficulties and in their anxiety to achieve progress promised by the new Reforms, counted on relief from the onerous contributions and constantly pressed for it. The financial arrangements under the constitutional reforms were based on high-pitched expectations about the possibilities of economic progress, which were not fulfilled. The value of the Montague-Chelmsford Reforms lay, in the public eye, in the opportunities that would be opened by them for improvement in social conditions and the betterment of the lot of the common people. This required the expenditure of funds which it was not possible to raise by additional taxation in the popular legislatures. Those Provinces, therefore, which benefited by the remission of their contributions, gained at the expense of the general tax-payer; and people elsewhere, *e.g.*, in Bombay and Bengal, had to share in the bur-

den of high taxation imposed and long maintained by the Central Government, without participating in the advantage derivable from it.

13. *Second Period.*—We have characterised the second period as a period of consolidation and improvement in the machinery and the management of the finances of the country and given the Finance Member of the time, Sir Basil Blackett, due credit for the skill and zeal with which he went about the business of reform. Separation of railway finance from the general finances of the country, outlay of large funds for the extension and improvement of the railways and irrigation works, reorganisation of public debt on a more systematic basis, reduction in the burden of interest charges, stabilisation of exchange, and the total remission of provisional contributions, are the principal achievements of the second period. During these years, however, seeds of the troubles of the third period were unconsciously sown. Government's exchange policy in 1920 was an admittedly costly failure, and the people of India had to pay for it dearly. Insistence of Government on adhering to the 18*d.* ratio in 1927 and persistence in it in later years, was another mistake whose consequences, though not quite apparent, have proved, nevertheless, equally disastrous. Though it may be argued with a show of fairness that Government's policy appeared to be correct in the light of the conditions as they then prevailed and as they promised to remain for some time, a retrospect of the events of the past few years, must convince every careful observer that the critics of Government were right. Since then, the subject of the exchange ratio has been frequently debated in the Legislature; and particularly owing to the recent disastrous fall in prices, Government has been pressed to repair its mistake. The proposal about a change in the ratio has been consistently met with the argument that tampering with it, was calculated to introduce into the economic and the financial conditions in India a dangerous element of disturbance and instability, calculated to prove detrimental to the best interests of the country. And to-day, the rupee having been divorced from gold and being linked to sterling, the whole currency system is surrounded with uncertainty, and another enquiry into it, is called for.

14. *Third Period.*—Instead of enjoying the apparently rich legacy left by the second period, the last few years have had to suffer from the consequences of the over-enthusiasm of that short spell of prosperity. All the achievements of that period serve to-day as a reminder of the human weakness of attempting to build hopes about the future on the narrow and weak foundations of fleeting good luck. We have quoted statistics from place to place to demonstrate the truth of this observation. Once more we have had a series of deficit budgets; the public debt position has deteriorated; Government's borrowing rates have had to be raised; instead of being reduced, taxation has been increased; sterling borrowing has been resorted to frequently; prices have shown an enor-

mous decline; capital-expenditure has been drastically cut down and the public's capacity to bear the burden of taxation and to contribute to State loans, has been exhausted. We appear to have reached a situation very similar to that of the early years of the decade, and retrenchment and drastic re-adjustment seem to be urgently called for. These facts and conclusions are writ large over the face of the Government of India's budget for 1932-33 and the speech the Finance Member made in explanation of it.

Though, at the moment, the immediate future is shrouded in darkness, it is already clear, even to Government, that the financial machinery of the country needs thorough overhauling. The Provinces are dissatisfied with their financial position, and with full provincial autonomy, they would like to have a substantial accession of resources to enable them to carry out their responsibilities. The position of the Central Government likewise needs strengthening, particularly in view of the demands of the Provinces and the possibilities of the Indian States coming into an all-India federation. This will mean a radical change in the financial organisation of the country and in the distribution of resources. These questions are already being discussed in connection with the momentous issues involved in the discussion now proceeding with respect to constitutional developments. The fate of the Indian system of national finance, therefore, hangs on the decisions that may be finally taken in this regard. The country obviously requires that its finances should be organised on a federal basis, with the Provinces and States occupying their proper positions in the system and with a central administration responsible to a popularly elected legislature. There is really small hope of substantial improvement in India's finances if the future constitution of the country is allowed to suffer from the grave defect which makes it impossible to-day for the executive Government to carry public opinion with it in the measures it thinks it fit to take in the course of its economic and financial administration.

15. *The Prospect of the near Future.*—In the process of the re-adjustment of world economy to changed conditions, this is fundamental so far as the problem concerns the future of our financial system. A mere tinkering with it or superficial changes in the system, will not serve the purpose. If the different aspects of the organisation of India's national finance are separately considered, the urgent need of a thorough enquiry and of radical alterations in the existing machinery, appears to be universally recognised. Even the Government of India has had a foretaste of what such reorganisation means. The proposed separation of Burma from India, the constitution of the North-West Frontier Province into a Governor's Province like the old Provinces and the proposed creation of Sind as a separate Province have raised issues the importance of which cannot be mistaken. The incorporation of the

Indian States in an all-India federation, is a step fraught with far-reaching consequences to India's finances; and it is essential that fundamental principles, to which attention has been drawn above, should not be lost sight of in seeking solutions of the various questions which confront the country at the present moment.

The present level of national expenditure will have to be considered with reference not only to the functions the Central Government of the future will be called upon to perform but to the people's capacity to bear the burden of taxation. Temporary cuts have been recently made in Government expenditure, but the long-standing complaint that the Indian administration is too costly for the resources of the people, will have to be carefully and impartially investigated and the nation's expenses will have to be adjusted to its economic condition. This is a very ticklish question but it will have to be squarely faced in the best interests of the country if financial reform is seriously intended. Indianisation of civil and military services and Parliamentary control over them, through the Secretary of State for India, are controversial issues involved in the solution of this problem of reduction of expenditure, but there is no escape from them, and Indian public opinion will have to be satisfied with respect to them. As regards sources of revenue, they have developed in a haphazard fashion in recent years. Taxes were levied and added to in accordance with the exigencies of the time, and it has not been possible to attend to the recommendations of the Taxation Enquiry Committee that reported years ago. The lack of elasticity and the operation of the law of diminishing returns in the case of certain sources of national income, have once more brought the question to the forefront. It is doubtful, however, if anything useful will be done in the direction of re-distribution of the incidence of taxation until economic conditions show a decisive tendency to stabilise themselves and the maximum national expenditure the country can bear, is determined.

In spite of the frequency with which the Indian system of currency and exchange has been examined and adjusted to changed conditions, it cannot be contended that a fresh enquiry into the existing circumstances, is superfluous and that what it needs is to be left to itself. Even in Great Britain, the question of the sterling-gold ratio will have to be shortly considered and the pound will have to be stabilised at a fixed level. Linking of the rupee to the fluctuating sterling, is, at best, a temporary expedient, and a mere reversion to the position as it was before the suspension of the gold standard, when the time is ripe for it, cannot meet the requirements of the country. The importance that was attached to the question of the rupee-gold exchange in the discussions of the Round Table Conference, is peculiarly significant, and reveals how intimately it is bound up with the economic, financial and constitutional future of India.

In matters of the public debt, capital outlay on productive works and railway finance, Government itself has advocated the necessity of enquiry, revision and re-adjustment. Provision that has to be made, out of revenue, for appropriation for "reduction and avoidance of debt" and the annual contribution to general revenues expected from State railways, are closely associated, and the examination of the railway convention has been already foreshadowed by Government. The vital bearing of this question on the state of general national finances, will be readily admitted, particularly when the proud declarations of Sir Basil Blackett with respect to Government's achievements in this field, are recalled. The employment of foreign capital, sterling borrowing for the purposes of the Indian Government and the mutual financial relations between India and Great Britain, specially with reference to Indian debt held in the latter country, are big issues which have been already raised in this connection; and they will need careful and impartial investigation. Similarly, the fiscal problem in relation to the political status and the economic conditions and requirements of India is being discussed, and its tremendous constitutional significance cannot be exaggerated. The fiscal convention and the proposed adoption by India of a scheme of Imperial Preference, are matters of vital national interest from the purely financial as well as the constitutional point of view. The entry of Indian States into a federation of the Indian nation, will add to the complexity of the position. It is needless to repeat that financial readjustment and reform in India are inextricably bound up with constitutional and political development and cannot be adequately and satisfactorily dealt with if they are handled as mere technical and administrative manipulations of the existing order of things. An intelligent and sympathetic national outlook and a close contact with and a clear understanding of the conditions and the aspirations of the Indian people, are an essential requirement of the study and the solution of the problem of the finances of the country.

INDEX.

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