WADIA & JOSHI

Plea for an effective Gold Standard in India.

M. 2/0

A PLEA FOR AN EFFECTIVE GOLD STANDARD IN INDIA

BY

Prof. P. A. WADIA, M. A.

AND

Prof. G. N. JOSHI, M. A.

Bombay:

Printed at the "Bombay Chronicle" Press by S. A. Brelvi and Published by P. A. Wadia.

A PLEA FOR AN EFFECTIVE GOLD STANDARD IN INDIA

BY

Prof. P. A. WADIA, M. A.

AND

Prof. G. N. JOSHI, M. A.

Bombay:

Printed at the "Bombay Chronicle" Press by S. A. Brelvi and Published by P. A. Wadia.

PREFACE.

Sir Purshotamdas Thakordas has given notice of his intention to introduce two bills in the September (1924) Session of the Legislative Assembly. One is intended to amend the Indian Paper Currency Act of 1923 with the object of substituting 7.53344 grains in the place of 11.33011 grains of gold per rupee, and the other to amend the Indian Coinage Act of 1920 changing the relation of the rupee to the English Sovereign from 1/10 in statute now existing to 1/15. If these two bills pass through the Legislature they will restore the pre-war currency system of India—a gold exchange standard with 1s—4d gold as the ratio of exchange.

We think it our duty to place before the country a case for giving to India an effective gold standard, instead of a gold exchange standard. We think it disastrous for our country that our own countrymen should ask for a gold exchange standard at 1s—4d. gold even as a temporary measure or as a first step towards the realisation of what is acknowledged to be the only sound system of money for every country in the world. If legislation, proposed or finally sanctioned by the constituted authorities, is the expression of the will of the nation, and if the national will of India can only demand whatever promotes the ultimate welfare of the people, then no compromise or temporisation with currency measures short of the effective gold standard is possible; and we plead today as emphatically as we can for a currency reform, that is acknowledged to be universally sound in theory and immediately practicable for India. What is theoretically sound is eminently practicable; and those today who limit their endeavours and their demands to any thing short of the effective gold standard are in one sense falling short of supreme loyalty to truth and humanity.

HORMAZD VILLA,
MALABAR HILL,
BOMBAY, *5th August* 1924.

P. A. WADIA,
G. N. JOSHI.

A PLEA FOR AN EFFECTIVE GOLD STANDARD IN INDIA.

INTRODUCTION.

A hundred years later when a future historian of India writes the story of the vicissitudes of the nation, he will notice, if he is an Englishman, the rapid opening up of the country by the Railway, the telegraph, the post office and the telephone, of the expansion of trade and the growth in the total volume of commerce which marked the last quarter of the nineteenth and the first quarter of the twentieth century ; he will notice, if he is an Indian, the rapid development of a common consciousness, born of common sufferings under an alien rule and fostered by the common struggles towards the achievement of national emancipation. But Englishman and Indian alike will notice, if urged by the passion for truth, that during the fifty years ending with the first quarter of the twentieth century, the economic life of India was subjected to a series of experiments bearing on currency and exchange, which, though they were apparently disconnected and forced on a lukewarm government by the exigencies of the passing hour, in their cumulative effect drained the capital resources of the country, deprived her of the gold balances which would have served as the foundations of her industrial development, and prevented the circulation of the life blood which in the form of credit would have built up her prosperity. It is significant that whereas one hears so much about the Partition of Bengal and the incidents of the Jallianwala Bag and the bombing of crowds from the air, about the evils of dyarchy and the persecution of a struggling press, one hears so little of the effects of the experiments with the Indian Currency which began with 1893 and of which we have not yet seen the end. The reasons are not far to seek. The effects of currency manipulations are subterranean and insidious ; a cut in the flesh may at once attract notice and be followed up by a remedy ; but the rapid advance of anaemia may very often escape observation, and if not remedied in time may end in the death of the organism. In the second place the importance of currency systems for the economic life of the body politic has been increasingly realised only in comparatively recent times ; with the marvellous development of credit and expansion, of large scale production, currency has a more vital function to perform than any other economic institution of our times ; and it was the war and post-war developments that aroused a bewildered Europe into a vivid consciousness of the supreme importance of currency. It is not to be wondered at if public opinion in India has hitherto been supremely indifferent to the details of currency legislation, to the complicated manipulations of her reserves by men trained in technical methods and possessing all the resources of the administrative machinery for adapting statistics to the refrain of popular economic shibboleths. Whilst the rest of the world at this moment is absorbed in devising methods of currency reform as the one thing needed to save the countries from economic ruin, we in India sit with folded hands and allow the Government to violate with impunity the elementary principles of currency and finance without a single note of protest on the part of our leaders.

IMPORTANCE OF CURRENCY.
NECESSITY FOR A GOLD STANDARD.

The world today has grown alive to the fact that all economic prosperity depends ultimately on the purchasing power of the people, and this purchasing power is considerably influenced for the better or for the worse by the monetary system of the country. Ever since the time of the Brussels Monetary Conference the attention of civilised mankind has been centred on the economic problems arising out of the breakdown of the foreign exchanges and of international trade, industrial and trade depression and unemployment. All these evils have been increasingly traced to currency, and their remedy sought in reform of currency.

The history of currency policy in the civilised world during the last few centuries has been the history of a series of attempts to secure relative stability of purchasing power by the alternate use of the two precious metals, gold and silver, as the standards of value and media of exchange. Unregulated bimetallism of a kind may be said to have prevailed in Europe up to the end of the eighteenth century. It was in 1816 that great Britain adopted a gold standard, and by the end of the nineteenth century the rest of the world with the exception of China either demonetised silver or relegated the silver currency to a subsidiary position. So far as India was concerned, though nominally the Act of 1899 placed it on a gold basis, as we shall point out later on, the gold was to be used only for stabilising her foreign exchanges. Before the outbreak of the war economic opinion and economic policy as manifested in the currencies of all civilised countries rested alike on the undisputed assumption that though absolute stability of purchasing power of the monetary unit in terms of commodities could not be secured, relative stability could be obtained only by the use of the gold standard. Now an effective gold standard implies in the first place that all values are to be measured in terms of a standard unit of gold defined by law, and secondly that all other media of exchange which are simultaneously in use, whether they are token coins, paper money, bills of exchange or cheques, are ultimately convertible into the standard coin. Such ultimate convertibility of all substitutes into the standard coins requires free and open mints, and a reserve of gold readily available for converting all other media of exchange into the standard currency for internal purposes and for shipment abroad in case of external liabilities. The preference attached to a gold currency by the civilised world is based on the experience gained through centuries by a process of trial and error that gold is the most suitable metal for money. Owing to its peculiar ingredients and characteristics, owing to the large stock of the metal in existence and its small annual production, gold was found to fulfil all the functions of sound money, and to secure relative stability in the purchasing power of the monetary unit in terms of commodities. Even the Cambridge economist who is now inclined to question the value of gold for the purposes of currency admits in his "Tract on Monetary Reform" that "the metal gold might not possess all the theoretical advantages of an artificially regulated standard, but it could not be tampered with and had proved reliable in practice." The growth of organised banking has during the last hundred years economised the use of gold for the purposes of internal currency to a phenomenal extent by the substitution of cheques for gold. The resulting expansion of credit has led to increased production, increased wealth and increase in population. This economic prosperity rested ultimately on such relative stability of the purchasing power of the monetary unit as was secured in practice by the use of gold as the basis of currency. Before the war gold had become an international currency by reason of the fact that everywhere in the world people want gold, and as a matter of fact are ready to accept gold under any circumstances. As the result of the war, however, two new conditions have come into existence. Firstly each of the belligerent countries, with the exception of the United States, has been compelled to issue an amount of paper money which is far in excess of the gold which would be required to make it redeemable. In the second place, in all the countries of the world except in the United States and in Sweden after April 1924 there exists a legal prohibition on the export of gold. These conditions have brought about phenomenal fluctuations in the foreign exchanges, a complete dislocation of trade, and violent disturbances in the internal level of prices in each country. The necessity of securing stability in the purchasing power of the monetary unit has been vividly brought home to all economic thinkers and to a suffering humanity by the international trade situation after the war.

Owing to the fact that most of the European countries have lost possession of the gold backing to their paper money which has become inconvertible, it is not surprising that economic experts should endeavour to formulate all kinds of measures, like the gold exchange standard and international loans. It has been seriously urged that the world today has given up its faith in gold, that this precious metal is no longer necessary as the basis of a sound system of currency, that "the gold standard is already a barbarous relic", and that the United States are playing a very foolish game in bottling up huge amounts of the metal which is no longer precious from an economic point of view, and that for the purposes of internal trade at any rate the use of gold is to be regarded as out-of-date and economically wasteful. It is true that in countries like France and Italy, as well as in South-Eastern Europe a return to an effective gold standard is out of question in the near future, and that these countries will have to be satisfied with an economically halting currency system ; but it is not true that a policy forced by circumstances is economically desirable and intrinsically sound. Whilst we admit that the variations in the purchasing power of gold have been during recent years so great as to lead a few people to doubt the advantage of using gold as a standard of value, the violent fluctuations in prices resulting from the use of inconvertible paper and the failure of the attempts at regulating the standard of value by legislation have in their turn made economic thought and public opinion welcome with eagerness the possibility of returning even to a bad gold standard. Nay, we may go further, and urge that perhaps it was the abandonment of the gold standard during the period of the war owing to the exigencies of the situation that is responsible for such fluctuations as we notice in the foreign exchanges and in the internal price levels. The possibility of a definite return to the gold standard is almost in sight in countries like Great Britain, Holland and Scandinavia. As early as 1920 the Cunliffe Committee recommended a policy of calling in and cancelling of currency notes until the pound sterling had been brought to its par value as measured by the dollar exchange. The Brussels Monetary Conference as far back as 1920 unanimously recommended that it was highly desirable that the countries that had lapsed from an effective gold standard should return to it. Prof. Gustav Cassel speaking in May 1924 before the Institute of Bankers in London observed that though he was no doctrinaire supporter of gold as a monetary standard, he believed it to be the only standard which the world would in practice accept at the present time. He pleaded that Britain should set an example to the rest of the world by restoring its currency to a gold basis at the earliest possible moment. In Great Britain banking opinion is in favour of as early a return to the gold standard as possible; and government have specifically declared their intention to carry out the Cunliffe Committee proposals. Even the enemies of Germany now recognise that the only way of making Germany pay is to put her currency on a gold basis.

Prof. KEYNES' VIEWS.

The one prominent if not solitary exception to this universally accepted principle of a gold standard as the one sound monetary system is Prof. Keynes. But even Prof. Keynes wrote in 1922 in the Manchester Guardian Reconstruction Number that if the gold standard could be reintroduced throughout Europe this would promote as nothing else can "the revival not only of trade and of production, but of international credit and the movement of capital to where it is needed most." Speaking of the problem of stabilisation he maintained in the same number that "hitherto only one good solution has been found, a world wide gold standard. I see no other solution of stabilisation now except this traditional solution, namely a gold standard in as many countries as possible." Since writing the above in 1922, Prof. Keynes has been a convert to a new method of regulating the currency, to a "more scientific" standard than the gold standard. In his "Tract on Monetary Reform" he emphatically asserts that in the past stability of foreign exchanges was the aim of the monetary system of the civilised world and that this was secured by an effective gold standard. He also admits that in pre-war days the effective gold standard secured not only stability in the foreign exchanges but also stability in internal price level. But he believes that gold now no longer retains its importance and he would concentrate attention on the desirability of securing internal stability by regulating and managing the currency, leaving the foreign exchanges to take care of themselves. Gold is not to be employed in circulation at all, its only use being that of a store of value to be held as a war chest against emergencies. Prof. Keynes assumes that stability of price level is intrinsically desirable, whilst we grant this position generally, we may well ask if a slow rise in prices spread over a number of years is not equally desirable in the interests of trade and industry. But our fear is that stability of price level that does not rest on a gold basis is so hypothetical in its character as to justify its being regarded as beyond practical politics.

It is conceivable that hereafter when the preference for gold to which mankind is hitherto attached is given up, a more scientific standard of values and medium of exchange may come into operation; and no one doubts even today the desirability of employing such a standard in the place of gold. But keeping in view the passionate love of gold amongst mankind at the present day, and the suspicion which attaches to any substitute for the precious metal, the only practicable standard of values for the civilised world is gold.

The civilised world is thus practically unanimous in recognising that the primary condition of economic development is stability of price level, and that this stability can be secured only by an effective gold standard. The increasing commercial interrelations between different parts of the world make it eminently desirable that every country thus linked up should have a common monetary substance for internal and external trade—for internal prices have become linked up with external prices, and we cannot experiment with foreign exchanges without very seriously affecting the internal price level. Now the policy of the Government of India ever since 1899 has been based upon the fundamentally wrong assumption that the primary want of this country in the matter of currency is the fixity of exchange between the silver rupee and the gold pound.

THE HISTORY OF INDIAN CURRENCY.

India had in very many parts a gold standard and a gold currency in the past. These were replaced by a silver standard and currency in the first half of the 19th century by the East India Company. The violent fluctuations which followed in the purchasing power of silver in terms of gold after 1870 led the Government of India to close the mints to the free coinage of silver. Their budget calculations especially in view of the Home Charges were violently upset in the years preceding 1893; with every fall of a penny in the value of the rupee the Government had to provide an additional crore of Rupees. The expansion of trade and the flow of capital to India were hampered by the uncertainties of the foreign exchanges. The members of the services who had to make remittances from time to time were seriously affected. These evils, the Government of India believed, could be obviated by the closure of the mints as a temporary measure and as the initial step towards the introduction of an effective gold standard. When after five years in 1898 the exchange rose to 1s—4d, as contemplated in 1893, the Fowler Committee recommended the introduction of the British Sovereign as "a legal tender and a current coin in India," and the opening of Indian mints to an unrestricted coinage of gold. The committee further observed: "Looking forward as we do to the effective establishment in India of the gold standard and currency on the principle of the free inflow and outflow of gold, we recommend these measures for adoption". These recommendations were accepted by the Government of India in their entirety; and by the Currency Act of 1899 the sovereign was made legal tender with the token silver coins in circulation as unlimited legal tender. Arrangements were made for opening a mint. But, soon after, owing mainly to the hostility of the British treasury, the project was shelved. It was specifically recommended by the Fowler Committee that no further coinage of rupees was to be resorted to till gold occupied a predominant position in circulation. The profit on the further coinage of rupees was to be set apart as a separate fund. The Government of India instead of scrupulously adhering to these recommendations discovered a fruitful source of profit in the further coinage of silver long before gold could be said to have occupied a predominant position in the currency. Instead of adopting an effective gold standard, the Government found in Mr. Lindsay's scheme—a scheme which was carefully examined and rejected by the Fowler Committee as undesirable and unsound—a remarkably convenient method of regulating the currency. It was a startling discovery by which gold could be economised, the dues of India could be settled and the gold thus economised could be conveniently used by the Government. This was the gold exchange standard which has been in operation in India ever since that time.

One great advantage which the Government of India discovered in the exchange standard was the facility with which it could build up from year to year from the profits of the coinage of silver a reserve in gold. Originally it was kept in India; but it was subsequently transferred to London on the ground that in case of an adverse balance India would be saved the cost of transmitting gold to London. This reserve is invested to a farthing in sterling securities; and it now amounts to 40 million pounds. Whilst public opinion in India has been clamouring for an effective gold standard, Government has continued to abide by the Gold Exchange Standard in practice, whilst professing to believe in the virtues of the simple gold standard. Thus as late as 1912 the Government of India wrote to the Secretary of State: "It is, we think, an undisputed fact that the establishment of a gold currency was regarded as the logical and natural sequence of the closing of the mints to silver and the necessary accompaniment of a gold standard. Such a measure will mark a step along the path which has been authoritatively accepted as the line on which our currency must develop, and in time it will be of great assistance in maintaining the stability of our currency system." Persistent agitation in India led the Government to appoint the Chamberlain Commission which reported in 1914. The Commission definitely advised the Government to abandon the idea of an effective gold standard and certified the then existing gold exchange standard. "To sum up," the Commissioners observe, "our view is that India neither demands nor requires gold coins to any considerable extent for purposes of circulation, that the most generally suitable media of internal circulation in India are at present rupees and notes, and that the Government should, as opportunity may offer, encourage notes, while providing—and this is the cardinal feature of the whole system—absolute security for the convertibility into sterling of so much of the internal currency as may at any moment be required for the settlement of India's external obligations".

Whilst the Chamberlain Commission was thus solemnly endorsing what it then believed to be the one scientific currency system for India, the war broke out, and led to the complete break down of the exchanges. India found herself a creditor on an enormous scale from year to year, and the rate of exchange rose from 1s—4d in 1914 to 2s—4d in 1919. The enormous obligations of India had to be liquidated; the Government went on purchasing silver and coining rupees till the price of silver reached 43d an ounce. But this easy expedient failed when the price of silver rose above 43d; any additional coinage would have involved the Government in heavy losses. The rate of exchange broke loose from its frail moorings; and by special ordinances the fiduciary portion of the Paper Currency Reserve which was only 14 crores of rupees before the war was increased till it reached nearly 100 crores in 1919. As the backing to his reserve Government showed investments in British Treasury Bills. In other words Indian exports during the war to the extent of nearly 75 crores of Rupees which should normally have been paid for in gold or in silver were paid for by the issue of paper money; and the gold that should have come to her was invested in British Treasury Bills. This was one expedient adopted by the Government when the Gold Exchange Standard broke down. But even this was not sufficient to liquidate India's obligations. The Government of India went to the rescue of the Government of Great Britain by asking India to make a gift of £100,000,000. To this extent India's balance was reduced. Amongst other expedients to adjust the balance during the war may be mentioned the issue of nickel coins, of one rupee and two and a half rupee notes and the resort to the "cover system" which compelled every exporter of Indian goods to find cover for his exports before he was allowed to send his goods abroad.

The complete break down of the foreign exchanges led the Government at the end of the war to appoint the Babington-Smith Committee, which once again sanctified the Gold exchange standard, but this time at the rate of 2sh to the rupee, instead of the earlier 1s—4d; but in the same breath that they recommended the gold exchange standard they also recommended the opening of a mint for the coinage of gold. The ratio was accordingly altered to 2sh by the coinage Act of 1920. Shortly after the price of silver fell below 2 shillings; the Government of India endeavoured to maintain the legal rate by the sale of reverse bills. Taking advantage of this situation all those in this country who had been unable to remit money during the war tendered rupees to the Government, at the 2 shilling rate, and bought a claim on the Secretary of State which the latter met from the liquidated Treasury Bills and other balances of India in London. This process went on for some time involving Government in a loss of nearly 40 crores of Rupees. At last the Government of India gave up the attempt to maintain the rate of exchange, on the ground that she was not prepared to fritter away India's gold resources. Though the legal rate of exchange remains at 2 sh the market rate has been left to itself and is determined by the volume of currency. The history of the foreign exchange in the last three years is a history of the failure of Government to maintain fixity of exchange by a system which they have always claimed to be scientific.

During the war India had enormous balances in her favour, like the United States of America. Had India been a self governing country, free to enforce her dues, she could like the United States of America, have wiped out her claims on Great Britain by asking Britain to transfer securities held by Englishmen in India, as the United States asked Great Britain to mobilise American Securities held by Englishmen and transfer them to the United States Government in exchange for her exports. But the difference between India and the United States is a difference between a dependent country and a self governing autonomous power: with the result that whilst the United States today is in possession of 62% of the world's gold stock, and financially and industrially a strong nation, India stands today with her finances crippled, her debt increased and her industries struggling.

THE GOLD EXCHANGE STANDARD EXAMINED.

Leaving this story of the gold exchange standard aside for a moment, let us examine the claims that have been made for its soundness generally, and specially in its application to India. The only economist of reputation who supported the gold exchange standard before the war was Prof. Keynes. In his "Indian Currency and Finance" he indicates the fundamental principle of a sound system of currency as below: "The currency problem of each country is to ensure that they shall run no risk of being unable to put their hands on international currency when they need it, and to waste as small a proportion of their resources on holdings and actual gold as is compatible with this." So also he contends that "as long as gold is available for payments of international indebtedness at an approximately constant rate in terms of the national currency, it is a matter of comparative indifference whether it forms the actual national currency." It is the same principle that the Chamberlain Commission, of which Prof. Keynes was a member, lays down as the cardinal feature of the gold exchange standard in India, namely "absolute security for the convertibility into sterling of so much of the internal currency as may at any moment be required for the settlement of India's external obligations." It may be noted however, that so far as India is concerned, this cardinal feature of the gold exchange standard does not exist, for there is no legal obligation on the part of the Government of India to convert the rupee into sterling.

If Prof. Keynes is to be taken at his word, the only purpose of a sound currency is to secure the fixity of foreign exchanges and to provide facilities for payment of foreign debts. Now any one who is familiar with the elementary principles of currency knows that a sound system of currency fulfils certain indispensable objects and satisfies a few basic needs of economic life. It supplies a standard of values, offers a universally acceptable medium of exchange, serves as a standard for deferred payments and as a store of values. All these objects can be summarised in the statement that a sound system of currency secures relative stability in the level of prices, or relative stability in the purchasing power of the monetary unit in terms of commodities. In the work to which we have referred Prof. Keynes makes fixity of foreign exchanges and an adequate provision to meet foreign obligations the be-all and end-all of a sound monetary system. But in his "Tract on Monetary Reform" he rightly gives up the earlier view and now maintains: "Stability of exchange is in the nature of a convenience which adds to the efficiency and prosperity of those who are engaged in foreign trade. Stability of prices, on the other hand, is profoundly important for the avoidance of the various evils" which he describes elsewhere. The one merit that is claimed for the gold exchange standard is that it secures stability of foreign exchanges, and now Prof. Keynes admits that this is only a convenience to those engaged in foreign trade and not of intrinsic importance to the soundness of a monetary system. What is even more startling is the confession by one on whom Sir Basil Blackett so explicitly relies that the gold exchange standard is useful in India only to those "who are engaged in foreign trade." So the monetary system of this country exists for the convenience of the foreign trade. But what about the other functions of good money? Assuming that the gold exchange standard secures stability of foreign exchanges, does it secure stability in the internal level of prices? Prof. Keynes points out himself that internal transactions are as important, if not more important than, external transactions in the economic life of a country; and if the gold exchange standard secures stability of foreign exchanges it leaves out of account altogether a vital portion of the economic life of our country.

Is it claimed on behalf of the gold exchange standard that it secures stability in the internal level of prices? Nobody can assert this in view of the history of prices in India between 1900 and 1914, when there was a rise in the price level of a character which has nothing analogous to it in the history of the price levels of other countries. Even Prof. Keynes in 1909 (Economic Journal) admits that "a comparison with Sauerbeck's index number for the United Kingdom shows that the change in India is much greater than can be accounted for by changes occurring elsewhere." In brief the gold exchange standard makes the whole internal currency inconvertible, with all the accompanying evils of over-issue and inflation of prices. Prof. Keynes, however, claims that India has secured, after the war, the advantages of a relatively stable level of internal prices. In the first place Prof. Keynes himself admits that this was brought about more perhaps by chance than by design. In the second place this relative stability of prices in India is a misleading statement, as it is the result of a comparison with countries that had overissued paper money and suffered from violent fluctuations in price level. And whatever relative stability of price level India possessed during the years after the war was due to the restriction of currency by the Government with a view to maintain a higher rate of exchange.

To sum up, the gold exchange standard sacrifices the fundamental objects of a sound monetary system to the desire to secure fixity of exchanges. In practice it has disastrously failed to secure this fixity of the foreign exchanges. It makes the internal currency inconvertible, and thus brings about instability in the internal level of prices, through over-issue and inflation. Thus it defeats the one object of a sound monetary system—namely relative stability in price level. There could be no more trenchant criticism of the gold exchange system than the verdict of the Cunliffe Committee in the final report. "We have found nothing in the experiences of the war to falsify the lessons of previous experience that the adoption of a currency not convertible at will into gold or other exportable coin is likely in practice to lead to over-issue and so to destroy the measure of exchangeable value and cause a general rise in all prices and an adverse movement in the foreign exchange."

THE EVILS OF THE GOLD EXCHANGE STANDARD IN INDIA.

(1) If we now turn to the practical operation of the gold exchange standard in India we cannot help noticing a few salient features of the system, and their adverse effects on the welfare of this country. In the first place under this system the rupee has been reduced to the position of an inconvertible note printed on silver; the printing of these notes is at the discretion of the government, and it is well known that the Government of India went on coining rupees between 1900 and 1905 irrespective of all considerations of the actual demand for money. Every student of economics knows that the one danger of inconvertible fiat money is over issue; and the Government of India have yielded to this temptation like any other human government. The one tangible proof of the over-issue of our rupee currency is to be found in the continuous rise in the level of prices in India from 1900 to our own days, whilst the level of prices in the rest of the civilised world remained comparatively steady. If the belligerent countries found themselves faced with abnormal fluctuations in the period of the war, the period that has followed has been marked by an equally noticeable downward tendency in those countries. The reasons for this inflation of prices in India are obvious. The additions to the rupee currency made from time to time owing to the normally favourable balance of trade are incapable of being withdrawn; the rupee currency admits of expansion but not of contraction. The rupee does not permit of being melted; people will not hoard it, because its value is arbitrary; and it has no use as a coin for export. Whereas under an automatic system of currency with an open mint and a standard coin there is a mechanism for the expansion and contraction of currency according to the needs of commerce under the gold exchange system there is ample provision for expansion, but not for contraction.

(2) As a result of this one-sidedness of the currency mechanism, we find the currency inelastic and incapable of readily responding to the demands of the market. In a country like India where there is a seasonal demand for currency and banking facilities are either unknown or undeveloped, the evils of an inelastic currency are accentuated by a system which makes the expansion of currency depend exclusively on the sweet will of the Government which is not in touch with the day to day requirements of the commercial community. This inelasticity is indicated by the violent fluctuations in the bank rate as between different months of the year. A study of these fluctuations

during the last thirty years is a sufficient condemnation of a monetary system whose main purpose can only be to supply money to the people when they want it; and the most striking illustration of the want of elasticity of our currency was afforded during the early months of this year when the rate of discount rose from 5 to 8% at a time when the country had an outstanding balance of several crores of rupees in her favour from week to week.

(3) Thirdly, the history of recent fluctuations in the foreign exchanges has been a history of heavy deficits in the Government of India budgets, owing to the discrepancies between the calculated rate of exchange and the actual market rate. These deficits have amounted to 90 crores of rupees during three years, and a considerable portion of these deficits was due to loss in exchange. A measure which was primarily devised for giving stability to the Indian budget and eliminating the element of uncertainty due to exchange fluctuations has after thirty years been attended by the same uncertainties and losses.

(4) In the fourth place the main ostensible purpose of the gold exchange standard is to stabilise the rate of exchange; the mechanism by which this is effected is the sale of Council Bills by the Secretary of State to an unlimited extent in normal times when the balance is in favour of India, and by the sale of reverse bills in exceptional years when the balance turns against India. There was no fear of exchange falling below 1s-4d, as long as India had a favourable balance, and the price of silver below 43d. But it must be remembered that it is always profitable to the Secretary of State to go on selling Council Bills to an unlimited extent to meet the demands of trade and increasing the profits on the coinage of rupees. But it is not equally profitable for the Government of India to sell reverse bills in case of an unfavourable balance, as this involves a depletion of the gold reserve in London. Thus the mechanism by which under the gold exchange standard stabilisation of exchanges is sought to be achieved has broken down whenever it has been seriously tested. If the mechanism worked smoothly for so many years, it was because the balance of trade was almost always in favour of India. The mechanism for stabilising exchanges can only be effective, if there is a legal obligation on the Government of India to convert rupees into gold. So long as this legal obligation does not exist, the mechanism is one-sided and can never be effective. We must never lose sight of the fact that so long as this legal obligation does not exist in India, the present currency system of India is not even a gold exchange standard strictly so called. It is a hybrid mechanism specially adapted to suit the convenience of those engaged in foreign trade in liquidating India's dues, and not even a "scientific" gold exchange standard.

(5) But this mongrel gold exchange standard has not merely a convenience for those engaged in foreign trade: the attachment of the Government of India to this beloved child which has now grown up into a well-built youth is founded on emotions of a more subtle type, which came into existence long after the closure of the mints

in 1893. The Fowler Committee in 1899 emphatically pronounced itself in favour of introducing a gold standard; the Government of India honestly accepted the recommendation, and the Act of 1899 was evidence of their intentions. It was only after the project of a mint was shelved, and when the possibilities of building up a large gold reserve out of the profits of coinage were revealed, that the theoretical advantages of the gold exchange standard first dawned on the mind of the Government. The fundamental advantage of such a system was that arising from the location of the gold reserve in London. The gold in the gold reserve Fund in London could be easily invested in Sterling securities thus easing the London market and strengthening the centralised gold reserve of the Bank of England. Appreciating these advantages the Chamberlain Commission in 1914 gave a scientific apologia for the prevalent system. One can well understand the depth of affection for the system on the part of Government when one remembers that the Gold Reserve Fund now amounts to more than £40,000,000 in addition to the cash balances of the Secretary of State and the sterling investments of the Paper Currency Reserve, all amounting to nearly £70,000,000. The location of £70,000,000 in London may be an immense advantage to England where the centralised liquid resources of the Bank of England do not exceed £150,000,000. What is, however, to the advantage of the London money market, is not necessarily to the advantage of this country. Gold does not, like the things of the spirit, multiply by being shared; and the gold that is kept in London is lost to India. If the currency system of India is devised primarily for the needs of India, then no system could be clumsier than the present for the satisfaction of those needs. For, India under the system is deprived of that immense quantity of gold which if it were kept in the country would suffice to build up a credit structure sound and secure, for the floating of her industries, for the development of her trade and for the relief of agricultural indebtedness which is so largely responsible for the backwardness of the country. And yet a system that hampers the economic and industrial life of the country is held up as the only sound monetary system for this country.

But it has been urged that the gold reserve should be located in London because in case of an adverse balance India will require gold in London. London is the clearing house of the world and gold in London means saving freight charges and interest, and payment on spot. This case for the location of the reserve in London is nowhere so clearly put as in a speech delivered by Sir Basil Blackett in December 1923. "For foreign debts must be paid in international currency. If India is called upon to meet her indebtedness at a time when she is unable to provide goods in sufficient quantity or in sufficiently short time to satisfy her creditors, she must find cash at short notice. Normally, an adverse balance could be met by borrowing cash; but borrowing abroad is not desirable in itself and in a crisis may become impossible. It is therefore necessary to keep reserves of ready cash for the purpose. It is essential that our external reserves should be available in case of need without delay at an international financial centre."

In the first place India is normally not a debtor, but a creditor country. She has to receive, and not to pay gold. Even if there is an adverse balance it can be adjusted by the operations of the bank rate or by the floatation of a temporary loan abroad. If these expedients fail, gold may be shipped abroad to meet her foreign obligations. But it may be urged that India has to pay every year home charges to the extent of nearly £30,000,000 and in case of an adverse balance there will be difficulty in the adjustment of accounts as India has a silver currency. Normally the home charges are met by the export of commodities covered by the Secretary of State's Bills; and these Council Bills are sold all throughout the year. In any case the balance of dues may be met by the shipment of gold in the last resort. One might ask Sir Basil how many countries, which do not compare so favourably with India in the matter of their international indebtedness, keep their reserves at an international financial centre? What would Sir Basil Blackett and the Bank of England say if it was proposed that the gold reserves now in the Bank of England should be transferred to New York to secure the solvency of Great Britain in the international market? Well might an eminent economist of the type of Prof. Cannan observe, "The possibility of a gold exchange system being perverted to suit some corrupt purpose is very considerably greater than the possibility of the simple gold standard being so perverted."

ARGUMENTS AGAINST THE USE OF GOLD.

The Chamberlain Commission in defending the gold exchange standard urges that gold will be hoarded in a country like India and will not be available for shipment in a crisis, that India is too poor a country to have such a luxury as a gold currency, that India is a land of small transactions and that gold in circulation is wasteful.

If by "gold in circulation" the Chamberlain Commission meant that every transaction was to be settled in gold, no economist will ever favour the use of gold. Every one now recognises that notes and cheques increasingly take the place of gold in the settlement of by far the larger number of commercial transactions. A gold standard with a gold currency does not mean any such absurdity as that every transaction should be settled in gold. But if the Commission mean that no gold at all is to be used as the basis of a currency system, and that any amount of gold is wasteful, however small, that is a position which we have already controverted when pleading for convertibility. On the contrary, as Sir James Begbie observes in his note attached to the Chamberlain Commission Report, the present system of currency tends to drive gold out of circulation, makes people hoard gold because there is no guarantee of converting token coins into gold when necessary. "The token currency not only prevents the holders of the gold from utilising it to some advantage, but the country as a whole loses the benefit that should accrue to it from the possession of great wealth.... If therefore the gold held in India is to be attracted into useful employment, it can, I think, be done only by providing security that when it is invested the investments will continue to represent gold and be convertible into gold, by means of a gold currency policy in which the public will have confidence."

As for the argument that gold will not be available for shipment in times of necessity, on account of the hoarding habits of the people, we have the recent experience of the free outflow of gold to the extent of nearly £100,000,000 from a country which has neither a gold currency nor a centralised national reserve in the country itself. This gold could only have come from the coffers of the people and there can be no more effective reply to the fears of those who say that gold will not be available for export.

If India is a country of small transactions all that is necessary is the provision of a larger volume of subsidiary token coins and the raising of the legal tender limit of the token coin to a higher level than obtains in other countries.

If to hoard gold is a crime India finds herself in good company in the United States of America. In the next place if India is too poor to use gold coins, there can be no possibility of her hoarding them. Even if she does hoard, this is a consequence of the gold exchange standard and not a reason for introducing it. The remedy against hoarding is restoration of public confidence by the introduction of a gold currency. India gets her gold as her dues for exports ; she can do what she likes with her own and no one can question her in the use of her property. The reason why India has a silver currency today and not a gold currency has been suggested by Prof. Cannan when he observes "Europeans like it (gold) so well that they cannot bear to part with any of it."

THE ONLY SOUND MONETARY POLICY FOR INDIA.

The only sound monetary policy for the Government of India from 1893 was the introduction of a gold standard and currency. The balance of trade is normally in favour of India from year to year. India can therefore like the United States of America demand the import of immense quantities of the precious metals, if her foreign exchanges were left to themselves. These might be made the basis of an effective gold standard securing the stabilisation of price level so vital not only to India but to the civilised world. With a free market for gold, and the free import and export of the metal, India would be in a position to save the rest of the world from the stagnation and depression that now threaten it, firstly in so far as such a free market would release for circulation the amounts hitherto hoarded or kept back from monetary use and secondly in so far as on the basis of a gold reserve in the country a credit super-structure on a larger scale might be erected to stimulate trade and industries, to promote agricultural production, and to quicken the process of economic development. The greatest economic need of India to-day is capital ; and if India had the gold standard which her foreign rulers have not yet given her this gold would be used for the creation of credit both internally and externally, enabling the country to buy from abroad the technique and the equipment necessary for her industrial development and also enabling her to relieve her agricultural population from the burden of indebtedness. The economic prosperity of India means today the prosperity of the European countries. The true remedy for unemployment in Great Britain does not lie so much in the shortsighted policy of using Indian gold for fostering industrial enterprise at home without the guarantees of a ready market abroad, as in giving to India the gold currency for which she has been clamouring so long—a policy which by stimulating Indian economic life will increase the purchasing power of the people and create a demand for English commodities. There is nothing so tragical in the economic history of India as this short-sighted policy of her rulers which has made them sacrifice the most elementary axioms of economic science in the desire to regulate foreign exchanges, in the desire to raise the rate of exchange to 1s—4d and even higher. There could be no more effective method of killing economic enterprise, of smothering trade than the currency policy of our rulers and it is just this method that the rulers pride themselves on having devised as "a scientific" policy. Even as late as May 1921 the Undersecretary of State for India in reply to a question made a statement which is either meaningless or misleading. He observed that "while effective restoration of the gold standard was the objective of Government policy, economic conditions throughout the world had not yet reached the degree of normality which would justify at present an attempt to stabilise the gold value of the rupee."

If the phrase "effective restoration of the gold standard" has a precise meaning it is that of giving to India a gold standard with convertibility of all substitutes into the standard metal; and yet it only means stabilising the gold value of the rupee,—a persistence in that fatal policy of regulating the exchanges which has repeatedly broken down in the past. But, what is still more tragic for India, is that in so far as this policy has succeeded, it has throttled the very sources of economic prosperity by violent fluctuations in the price level and by drying up the fountain of credit.

The Gold Exchange Standard has been tried and failed. Economic thought and policy alike have pronounced themselves definitely in favour of the gold standard. The restoration of the gold standard is regarded as the most pressing of economic measures for the restoration of world prosperity. India by her position as a creditor country can command much more gold than she would require for the establishment of an effective gold standard. The present time is exceedingly opportune for the purpose, with a favourable balance and the steady and increasing world demand for India's food produce and raw materials. Instead of doing the one thing so vital to her prosperity,—giving an effective gold standard to the country,—the Government of India resort to the short-sighted, ill advised measure of limiting the volume of currency with a view to pushing still further the rate of exchange. With a favourable balance and limitation of the volume of currency, any rate of exchange can be artificially achieved and maintained. But such an achievement can be brought about only at the cost of all other factors of healthy economic life;—it has meant, and can only mean the prolongation of trade depression, of unemployment and starvation, of that monetary stringency which is so fatal to the rise and development of industries in a country lacking in banking facilities and organisation of credit. The Government of India are fond of constantly reiterating their paternal interest in the development of the material resources of the country and their concern in fostering her industrial welfare : they point to their readiness of late to give up their traditions of free trade and to endorse a policy of protection by import duties of key industries. But all talk of protection is meaningless, and all import duties are futile so long as with a favourable trade balance this country is artificially subjected to such monetary stringency as is indicated by a bank rate of 7 to 8% for months together.

If the monetary policy of India is to be managed by her foreign rulers, this country is entitled to the claim that it should be managed primarily with a view to her own interests ; this policy for the last thirty years has, however, been managed ostensibly with the single object of stabilising the rate of exchange ; the primary function of stabilising price level has been ignored, with the result that her trade, her industries, her agriculture,—her economic life in general has been throttled, the sources of her life blood are dried up; instead of having an automatic machinery which would secure the expansion and contraction of the volume of currency according to her needs she finds herself at the mercies of a Government that starves the country of its monetary requirements, for the sake of regulating the rate of exchange.

The Government of India still persist in the worn out, discredited, fatal policy of stabilising the exchanges. Sir Basil Blackett spoke in December 1923 of "our aim" being "to reach a gold standard for the Rupee." The Under Secretary of State for India in May 1924 confirms this intention of the Government "to stabilise the gold value of the Rupee". In July 1924 Sir Basil Blackett said : "Our policy is to reach 1s. 4d. gold at the earliest possible moment." The Government of India are more outspoken in favour of the Gold Exchange Standard than they ever were before. The question is once more brought to the fore by the Bills that stand in the name of Sir Purshotamdas Thakordas, and those friends of India who see the economic salvation of their country only in the adoption of a gold standard pure and simple are faced with the alternatives "now or never."*

P. A. WADIA.
G. N. JOSHI.

---

*For the information of Sir Purshotamdas and the Indian Merchants Chamber and other Chambers *also* we quote the following resolution passed by the Brussels Monetary Conference :

"Attempts to limit fluctuations in exchange by imposing artificial control on exchange operations are futile and mischievous. In so far as they are effective they falsify the market, tend to remove natural correctives to such fluctuations and interfere with free dealings in forward exchange which are so necessary to enable traders to eliminate from their calculations a margin to cover risk of exchange, which would otherwise contribute to the rise in prices. Moreover all Government interference with trade, including Exchange, tends to impede that improvement of the economic condition of a country by which alone a healthy and stable exchange can be secured."