

a fall in the value of a currency in terms of a particular commodity such as gold, then there has been no excess at all in terms of commodities in general. Now there was a time, particularly during the discussion on the Bullion Report, when the conception of a change in the value of the currency in relation to things in general was not quite clear even to the most informed minds,* and was even pronounced invalid by high authorities.† In view of the absence of the system of index numbers, this simple faith in the summary method of ascertaining depreciation by some one typical article, gold for instance, as a measure of value, was excusable. But the same view is without any foundation to-day. No one now requires to be shown that the price of each commodity has varied to the same extent and in the same direction as prices of commodities in general before admitting that there has been a change in the value of a currency. Why assume a single commodity like gold as a measure of depreciation? It would be allowable, although it is short-sighted to do so, if the depreciation of gold was an accurate measure of the depreciation of a currency in terms of all other commodities. But such is not the case. Commenting upon the experience of the United States with the greenbacks during the Civil War, Prof. W. C. Mitchell observes‡ :

“The fluctuations in the price of gold which attracted so much attention were much more moderate than the extreme fluctuations in the prices of commodities. The gold quotations lay all the time well within the outer limits of the field covered by the variations of commodity prices..... During the war gold moved up or down in price more quickly than the mass of commodities..... When gold was rising in price the majority of the commodities followed, but more slowly..... When gold was falling in price the majority of commodities stood still or followed more slowly..... This more sluggish movement of commodity prices appears still more clearly after the war. Rapid as was the fall of prices it was not so rapid as the fall in gold. A more curious fact is that the price-level for

* Canning's castigation of Lord Castlereagh's definition of standard as “a sense of value” during the Bullion debates must be attributed to his ignorance on this matter.

† Ricardo, in his *Proposals for an Economical and Secure Currency* says : “It has indeed been said that we might judge of the value of a currency by its relation not to one but to the mass of the commodities..... Such a test would be of no use whatever..... To determine the value of a currency by the test proposed..... is evidently impossible.”

‡ *Gold Prices and Wages under the Greenback Standard*, 1908, pp. 39-41.

commodities continued for ten years to be higher than the price-level for gold.”

This shows that the test sought to be applied by the adherents of the exchange standard is a false one and gives an inaccurate reading of the value of a currency. There can be no doubt that people who have urged its application to that standard would not have pressed for it so much as they have done if they had taken proper care to distinguish between *specific* depreciation of a currency in terms of gold and its *general* depreciation in terms of commodities.* The experience of the Bank of England during the suspension period is a capital instance of the phenomenon where a currency is generally depreciated, although it showed no sign of specific depreciation :—

TABLE L
DEPRECIATION OF THE NOTES OF THE BANK OF ENGLAND†

				Percentage Values of Bank Notes in Terms of	
				(1) Gold	(2) Commodities
1797	...	...	...	100.0	110
1798	...	...	...	100.0	118
1799	...	...	...	...	130
1800	...	...	...	107.0	141
1801	...	...	...	109.0	153
1802	...	...	...	...	119
1803	...	...	...	...	128
1804	...	...	...	103.0	122
1805	...	...	...	103.0	136
1806	...	...	...	...	133
1807	...	...	...	...	132
1808	...	...	...	...	149
1809	...	...	...	...	161
1810	...	...	...	...	164
1811	...	...	...	123.9	147
1812	...	...	...	130.2	148
1813	...	...	...	136.4	149
1814	...	...	...	124.4	153
1815	...	...	...	118.7	132
1816	...	...	...	102.9	109
1817	...	...	...	102.2	120
1818	...	...	...	104.6	135

* Cf. Prof. Nicholson's *Principles of Political Economy* (1897), Vol. II, Chap. XV, §4; and Walker, F. A., *Money*, 1878, pp. 387-91.

† From Hawtrey's *Credit and Currency*, p. 269. On the values of the notes in terms of gold Prof. Foxwell says: "It is admitted by the severest critics of the bank that there is no substantial ground for complaint as to its conduct during the restriction until 1808-9. There does not seem, indeed, to have been any real depreciation of its paper until that date. The price of £ 4 per ounce, which figures monotonously for the years 1803-9, was really an arbitrary price, fixed by the bank itself as one at which it would purchase foreign gold." *Preface to Andreades*, p. xvi. Some people seem to doubt that there was no specific depreciation of the inconvertible notes of the Bank of England till 1810. Unfortunately data are not available to give direct evidence of the fact. But circumstantial evidence there is. It is to be remembered that the premium on gold was the only method then known of measuring depreciation and that Horner, Ricardo and others were open enemies of the Bank of England. That being the case, it does not seem probable that Horner would have waited to introduce his Resolution in the House of Commons till 1810 if the bank notes had shown signs of specific depreciation before that time.

Which kind of depreciation is the greater evil we will discuss in the next chapter. Dealing for the present with this experience of the Bank of England, we have the fact that there can be a general depreciation without a specific depreciation. In view of this, the upholders of the exchange standard have no reason to be proud of the fact that the rupee has not shown signs of specific depreciation over periods of long duration. That a bank note absolutely inconvertible and unregulated as to issue should have maintained its par for very nearly thirteen years may speak far more in favour of the suspension system than the experience of the rupee can in favour of the exchange standard. There is a greater wonder in the former than there is in the latter, for the value of the rupee is sustained, apart from the fact that gold in terms of which it was measured was itself undergoing a depreciation, as is evident from the foregoing figures of general prices in England, and by a hope in some kind of convertibility, however slight or however remote but which had no place in the case of the Bank of England notes. Yet no one is known to have admired or justified the currency system of the suspension period, although it had not given rise to a specific depreciation for a long time.

This mode of measuring depreciation in terms of gold would be, relatively speaking, a harmless idea if it was not made the basis of another assumption on which the exchange standard is made to rest, that the general and specific depreciations of a currency are unrelated phenomena. As against this it is necessary to urge that the chief lesson to be drawn from this experience of the Bank of England for the benefit of the upholders of the exchange standard consists in demonstrating that although their movements are not perfectly harmonious, yet they are essentially inter-related. That lesson may be summed up in the statement that when the general depreciation of currency has taken place the occurrence of a specific depreciation, other things being equal, is only a matter of time, if the general depreciation proceeds beyond a certain limit. What will be the interval before specific depreciation will supervene upon general depreciation depends upon a variety of circumstances. Like the surface of a rising lake, general depreciation touches different commodities at different times according as they are located in the general scheme of things as determined by the relative strength of demand for them. If there is no demand for gold for currency purposes or for industrial purposes, the

depreciation of the currency in terms of gold may be delayed. It is only to make foreign remittances that the demand for gold first makes itself felt, and it is there that specific depreciation primarily arises. But there again it need not, for everything depends upon whether other commodities equally good, which the foreigner would take as readily as gold, are forthcoming or not. Now, in the case of India all these three factors tending to postpone specific depreciation are more or less operative. The rupee is a full legal-tender currency and can effectively discharge debts without compelling resort to gold. The industrial demand for gold in a poor country like India cannot be very great.* Consequently, the generally depreciated rupee does not show immediate signs of depreciation in the internal trade of the country. As for foreign payments, the position of India is equally strong, not because, as is absurdly supposed, she has a favourable balance of trade, but because she has certain *essential* commodities which a foreigner is obliged to

* The following table regarding the consumption of gold in different countries is interesting:—

§ CONSUMPTION OF GOLD (MILLIONS OF POUNDS STERLING AT 85s.
PER FINE OUNCE)

	1915	1916	1917	1918	1919	1920
Industrial Arts (Europe and America).	17.0	18.0	16.0	17.0	22.0	22.0
India (year to March 31 following.	1.4	5.1	19.6	—3.3	27.7	5.1
China ...	—1.7	2.6	2.6	0.04	11.5	—3.7
Egypt ...	—0.8	—0.2	—0.1	—0.0	—0.0	?
Balance available as money (difference).	80.5	68.0	48.2	64.9	13.8	46.6
World ...	96.4	93.5	86.3	79.0	75.0	70.0

§ The figures are those of Mr. Joseph Kitchin in *The Review of Economic Statistics*, Preliminary volume 3, No. 8 for August, 1921, p. 257. If figures previous to 1914 are desired, *see* table *ibid.*, p. 258).

Omitting the abnormal years of 1917 and 1919 and reducing the figures to *per capita* basis the *consumption* of gold by India must be said to be remarkably small. Besides, it is to be noted that figures for India include industrial as well as monetary consumption. Further, in making comparison account must be taken of the difference in the period taken as unit in the case of India and other countries. Of course in these days when gold is so very greatly depreciated in terms of commodities in general, neither is there any necessity to shed tears if its production were to fall off, nor can it be anything but a welcome event if its use were to be extended. It would therefore be unwise to resent an increase, if it were to take place, in the importation and use of gold by India. The greater the use of gold and the less the production of it, the better for the world as it is circumstanced to-day. Cf. in this connection the remarks of Prof. Cannan on Mr. Shirras's Paper in the *J.R.S.S.* for July, 1920, pp. 623-24.

accept* in place of gold. Specific depreciation of the rupee will occur chiefly when the general depreciation has overtaken the commodities that enter into India's foreign trade. That the depreciation should extend to them is inevitable, for, as is well said,†

“in a modern community the prices of different goods constitute a completely organized system, in which the various parts are continually being adjusted to each other by intricate business process. Any marked change in the price of important goods disturbs the equilibrium of this system, and business processes at once set going a series of readjustments in the prices of other goods to restore it.”

It is true that in the case of India the interconnection between production for internal trade and production for external trade is not so closely knit as in the case of other countries. The only difference that this can make in the situation is to moderate the pace of general depreciation so that it does not affect foreign trade commodities too soon. But it cannot prevent its effect from ultimately raising their price, and once their price is risen the foreigner will not accept them, however essential. A demand for gold must arise, resulting in the specific depreciation of the currency. This statement of the case agrees closely with the experience of the Bank of England and that of India as well. In the case of the Bank of England the “great evil,” i.e. the specific depreciation of the bank notes, of which Horner complained so much, made its appearance in 1809, some thirteen years after the suspension was declared. Similarly, we find in the case of India specific depreciation tends to appear at different intervals, thereby completely demonstrating that, even for the purpose of avoiding specific depreciation, it is necessary to pay attention to the general depreciation of a currency.

Having regard to these facts, supported as they are by theory as well as history, the incident that the rupee has maintained its gold value over periods of some duration need not frighten

* Evidence of Prof. Marshall, I.C.C. 1898, Q. 11,793.

† Mitchell *Ibid*, p. 258.

anyone into an admission that the exchange standard is therefore a stable standard. Indeed, a recognition of that fact cannot in the least discredit what has been said above. For our position is that in the *long run* general depreciation of a currency will bring about its specific depreciation in terms of gold. That being our position, even if we are confronted with the absence of specific depreciation of the rupee, we are not driven to retract from the opinion that the best currency system is one which provides a brake on the general depreciation of the unit of account. The exchange standard provides no such controlling influence; indeed, its gold reserve, the instrument which controls the depreciation, is the direct cause of such depreciation. The absence of specific depreciation for the time being is not more than a noteworthy and an interesting incident. To read into it an evidence of the security of the exchange standard is to expose oneself, sooner or later, to the consequences that befall all those who choose to live in a fool's paradise.

●●

CHAPTER VII

A RETURN TO THE GOLD STANDARD

We have examined the exchange standard in the light of the claim made on behalf of it, that it is capable of maintaining the gold parity of the rupee. This was the criterion laid down by the Chamberlain Commission as a fitting one by which to judge the merits or demerits of that standard. But is the adequacy of that criterion beyond dispute? In other words, supposing the rupee has maintained its gold parity, which it has only as often as not, does it follow that all the purposes of a good monetary system are therefore subserved?

In the exchange standard, “as the system is now operated, the coinage is manipulated to keep it at par with gold”* as though money is only important for the amount of gold it will procure. But what really concerns those who use money is not how much gold that money is worth, but how much of things in general (of which gold is an infinitesimal part) that money is worth. Everywhere, therefore, the attempt is to keep money stable in terms of commodities in general, and that is but proper, for what ministers to the welfare of people is not so much the precious metals as commodities and services of more direct utility. Stability of a currency in terms of gold is of importance only to the dealers in gold, but its stability in terms of commodities in general affects all, including the bullion-dealers. Even Prof. Keynes, in his testimony before the Indian Currency Committee of 1919, observed† :—

“I should aim always..... at keeping Indian prices stable in relation to commodities rather than in relation to any particular metallic or particular foreign currency. That seems to me of far greater importance to India.”

It is, of course, a little difficult to understand how the remedy of high exchange which he supported was calculated to achieve that object. Raising the exchange was a futile project, in so far

*Fisher, *Purchasing Power of Money*, 1911, p. 340.

†Q. 2,690.

as it was not in keeping with the purchasing power of the rupee. As an influence governing prices it could hardly be said to possess the virtue he attributed to it. The existing price-level it could affect in no way; nor could a high exchange prevent a future rise of prices. It could only change the base from which to measure prices. Future prices could vary as easily from the new high base-line as prices did in the past from the old baseline. In other words, Mr. Keynes seems to have overlooked the fact that exchange was only an index of the price-level, and to control it, it was necessary to control the price-level and not merely give it another name which it cannot bear and will not endure, as was proved in 1920 when the rupee was given in law the value of 2s. (gold) when in practice it could not fetch even 1s. 4d. sterling, with the result that the rupee exchange sank to the level determined by its purchasing power. But, apart from this question, we have the admission of the ablest supporter of the exchange standard that the real merit of a currency system lies in maintaining the standard of value stable in terms of commodities in general.

Given that this is the proper criterion by which to judge a currency system, we must ask what has been the course of prices in India since the Mint closure in 1893? This is a fundamental question, and yet not one among the many who have praised the virtues of the exchange standard has paid any attention to it. In vain may one search the pages of Prof. Keynes, Prof. Kemmerer, or Mr. Shirras for what they have to say of the exchange standard from this point of view. The Chamberlain Commission or the Smith Committee on Indian currency never troubled about the problem of prices in India,* and yet without being satisfied on that score it is really difficult to understand how anyone can give an opinion of any value as to the soundness or otherwise of that standard.

In proceeding to consider the exchange standard from the standpoint of prices, it is as well to premise that one of the important reasons why the Indian Mints were closed to the free coinage of silver was that the rupee was a depreciating currency resulting in high prices.† The dosing of the Mints, therefore,

* Perhaps an exception may be made in the case of the latter Committee; but its object was only to make it a ground for high exchange.

† See *supra*, Chap. III.

should have been followed by a fall of prices in India; for, to adopt the phraseology of Prof. Fisher,* the pipe-connection between the money reservoir and the silver-bullion reservoir was owing to the Mint closure cut off or stopped, thereby preventing the passage of silver from the bullion reservoir to the money reservoir. In other words, the newly mined silver could not become money after the Mint closure and lower the purchasing power of the rupees in circulation. If this is so, then how very disappointing has been the effect of the Mint closure ! From the standpoint of prices the rupee has become a problem as it had never been before. The rise of prices in India since the Mint closure (*See Chart VI*) has been quite unprecedented in the history of the country. Indeed, the rise of prices in India before the Mint closure, when the pipe-connection between the silver-bullion reservoir and the rupee-currency reservoir was intact, must be regarded as very trifling compared with the rise of prices after the Mint closure when the pipe-connection was cut off. From the standpoint of prices the Mint closure has therefore turned out to be a curse rather than a blessing, and literally so, for, under an ever-rising price-level, life in India is rendered quite unbearable. No people have undergone so much misery owing to high prices as the Indian people have done. During the war period the price-level reached such a giddy height that the reports of suicide by men and women who were unable to buy food and clothing were in no way few and far between, it may, however, be argued that the rise of prices in India would have been greater if the Mints had not been closed and India had remained a purely silver-standard country. A good deal, no doubt, can be said in favour of this view. It is absolutely true that silver, being universally discarded, has become unfit for functioning as a standard of value. To that extent an exchange standard is better than a pure-silver standard. But is it as good as a gold standard ?

On the basis of the doctrine of purchasing power parities as an explanation of actual exchange rates, one may be led to answer the question in the affirmative. For it may be argued

**Purchasing Power of Money*, 1911, p. 128.

that if the gold value of the rupee was maintained it is because gold prices and rupee prices were equal.* This, it may be said, is all that the exchange standard aims at doing and can be claimed to have done, for the fact that the gold-standard reserve was seldom depleted is a proof that the general prices inside India were on the same level as those ruling outside India. On *a priori* considerations such as these, the exchange standard may be deemed to be as good as a gold standard.

One may ask as to why Indian prices should have been kept as high, if they were no higher than gold prices, and whether it would not have been better to have kept Indian prices on a lower level. But we shall not raise that question. We shall be satisfied if Indian prices were only as high as gold prices. Now did Indian prices rise only as much as gold prices? A glance at the chart reveals the surprising phenomenon that prices in India not only rose as much as gold prices, but rose more than gold prices. Of course in comparing Indian prices with gold prices to test the efficacy of the exchange standard we must necessarily eliminate the war period, for the reason that gold had been abandoned as a standard of value by most of the countries. And, even if we do take that period into account, it does not materially affect the conclusion, for although India was not a belligerent country, yet prices in India were not very much lower than prices in countries with most inflated currencies during the war, and barring a short period were certainly higher than gold prices in U.S.A.

It is obvious that the facts do not agree with the *a priori* assumption made in favour of the exchange standard. So noticeable must be said to be the local rise in Indian prices above the general price level in England that even Prof. Keynes, not given to exaggerate the faults of the exchange standard, was, as a result of his own independent investigation, convinced 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.”

* It is, however, to be noted that neither Prof. Kemmerer nor Prof. Keynes has set up this claim in favour of the exchange standard. If anything, both have argued against the assumption of there being equality of *all* prices.

† “Recent Economic Events in India,” in *The Economic Journal*, March, 1909, p. 54. Italic not in the original.

What is then the explanation of this discrepancy between the *a priori* assumption and the facts of the case. The explanation is that the actual exchange rates correspond to the purchasing power parities of two currencies not with regard to *all* commodities but with regard to *some* only. In this connection it is better to re-state the doctrine of the relation of the purchasing power parities to exchange rates with the necessary qualification. A rigorously strict formulation of the doctrine should require us to state that Englishmen and others value Indian rupees inasmuch as and in so far as those rupees will buy *such Indian goods as Englishmen want*; while Indians value English pounds inasmuch as and in so far as those pounds will buy *such English goods as the Indians want*. So stated it follows that the actual exchange rates are related to purchasing power parities of the two currencies with regard to such commodities only as are internationally traded. To assume that the actual exchange rate is an exact index of the purchasing power parity of the two currencies with regard to *all* the commodities is to suppose that the variations in the purchasing power of a currency over commodities which are traded and which are not traded are the same.* There is certainly a tendency for movements in the prices of these two classes of goods to influence one another *in the long run*; so that it becomes possible to say that the exchange value of a currency will be determined by its internal purchasing power. The doctrine of purchasing power parity as an explanation of exchange rates is valuable as an instrument of practical utility for controlling the foreign exchanges *and* it is as such that the doctrine was employed in an earlier portion of this study to account for the fall in the gold value of the rupee. But to proceed, on the basis of this relationship between the purchasing power of a currency and its exchange value, to argue that at any given time the exchange is more or less an exact measure of general purchasing power of the two currencies, is to assume what cannot always be true, namely, that the prices of traded and non-traded goods move in sympathy. This assumption is too large and can only be said to be more or less true according to circumstances. Now as Prof. Kemmerer† points out:—

*Prof. Cassel, the modern exponent of this old doctrine of the relation of exchange rates to purchasing power parities, admits that the correspondence between the two depends upon the fulfilment of this assumption, for he says :

“Our calculation of the purchasing power parity rests strictly on the proviso that the rise in prices in the countries concerned has affected all commodities in a like degree. If that proviso is not fulfilled, then the actual exchange rate may deviate from the calculated purchasing power parities.”— *Money and Foreign Exchange after 1914*, London, 1922, p. 154.

†Op. cit., p. 64.

“While India’s exports and imports in the absolute are large, still, in the main, the people of India live on their own products, and a large part of those products run their life history from production to consumption in a very small territory. They have only the remotest connection with foreign trade, gold, and the gold exchanges. In time, of course, any substantial disturbance in the equilibrium of values in the country’s import and export trade will make itself felt in these local prices, but allowing for exceptions, it may be said that in a country like India the influences of such disturbances travel very slowly and lose much of their momentum in travelling.”

In consequence of the thinness of connection between the two it is obvious that the prices of such Indian goods as do enter into international trade cannot always be said to move in more or less the same proportion as those which do not. Besides this thinness of connection which permits of deviations of the general purchasing power of a currency from the level indicated by the actual exchange rate, it is to be noted that the prices of Indian commodities which largely enter into international trade are not governed by local influences. Such exports of India as wheat, hides, rice and oil seeds are international commodities, not solely amenable to influences originating from changes that may be taking place in the prices of home commodities and services. The combined effect of these two circumstances, except in abnormal events such as the war, is to militate against the prices of traded and non-traded goods moving in quick sympathy.*

If this is true, then, although the maintenance of the exchange standard does imply a purchasing power parity of the rupee with gold, it is not a purchasing power parity of the two currencies with respect to *all* the commodities. All that it implies is that the purchasing power of the rupee over such commodities as entered into international trade was on a par with gold, so that there did not often arise the necessity of exhausting the gold reserve. The preservation of the gold reserve only meant that there was equality of prices so far as internationally traded goods were concerned. Thus interpreted, the fact that the rupee

* This is merely re-stating what has previously been stated to explain why specific depreciation of the rupee does not immediately follow upon its general depreciation.

maintained its gold value does not preclude the possibility of Indian prices being, on the whole, higher than gold prices, thereby vitiating the *a priori* view that the exchange standard is as good as the gold standard.

It should be pointed out* that all changes of prices affect more or less the welfare of the individual. However, the general flexibility of the modern economic organization, with its mobility of capital and labour, free competition, power of choice, inventive genius and intellectual resources of entrepreneurs and merchants, takes care of the normal and temporary fluctuations of prices. But when a change in the price-level is general and persistent in one direction the case is otherwise. Arrangements based on the expectation that the price movement is only temporary, and that there will be a return to the former normal position, constantly come to naught. Suffering endured in holding on for the turn in the movement cannot be offset by gains in another. In short, such a persistent price movement in one direction is bound to confound ordinary business sagacity and so vitiate all calculations for the future as to result in unlimited dislocation or loss and subject the individual to such powerful and at the same time incalculable influences that his economic welfare cannot but escape entirely from his control, and prudence, forethought, and energy become of no avail in the struggle for existence. Perfect stability of value in a monetary standard is as yet only an ideal. 'But the evil consequences of instability are so great that Prof. Marshall, believing as he did that the general prejudice against tampering with the monetary foundations of economic life was a healthy prejudice, yet observed that much may be done towards safeguarding the economic welfare of communities by lessening its variability.† A depreciating standard of value, as gold has been since 1896, is an evil. But can a standard of value, undergoing a continuous depreciation as has been the case with the exchange standard, and that too of a greater depth than the gold standard—in other words, causing a greater rise of prices—be regraded as a good standard of value ?

* What follows is condensed from Mayo-Smith's "Price Movements and Individual Welfare," in the *Political Science Quarterly*, Vol. XV, No. 1 (March, 1900), pp. 14-17.

† Cf. "Remedies for Fluctuations of General Prices," in *The Contemporary Review*, March, 1887, *passim*.

In the light of this it is strange that Prof. Keynes, in his treatise on *Indian Currency and Finance*, should have maintained that the exchange standard contained an essential element in the ideal standard of the future*—a view subsequently endorsed by the Chamberlain Commission. If stability of purchasing power in terms of commodities in general is the criterion for judging a system of currency, then few students of economics will be found to agree with Prof. Keynes. Perhaps it is not too sanguine to say that even the Prof. Keynes of 1920 will prefer a gold standard to a gold-exchange standard, for under the former prices have varied much less than has been the case under the latter.

In this connection attention may be drawn to the prevalent misconception that India is a gold-standard country. It will be admitted that the best practical test whether any two countries have the same standard of value is to be found in the character of the movements in their price-levels. So sure is the test that Prof. Mitchell, after a very careful and wise survey of the price-level of different countries and the American price-level during the greenback period, was led to observe† that

“when two countries have a similar monetary system and important business relations with each other, the movements of their price-levels as represented by index-numbers are found to agree rather closely. This agreement is so strong that similarity of movement is usually found even when comparisons are made with material so crude as index-numbers compiled from unlike lists of commodities and computed on the basis of actual prices in different years.” Now, we know that before the war England was a gold-standard country, and we also know that there was no close correspondence between the contemporary movements of the price-levels of India and England. In view of this, it is only a delusion to maintain that India has been a gold-standard country. On the other hand, it is better to recognise that India has yet to become a gold-standard country unless we are to fall into the same error that Prof. Fisher‡ must be said to have

* Op. cit., p. 36.

† *Gold, Prices, and Wages under the Greenback Standard*, 1908, p. 27.

‡ *Purchasing Power*, etc., 1911, p. 340.

committed in attributing the extraordinary rise of prices in India to the existence of a gold standard, when, as a matter of fact, it should have been attributed to the want of a gold standard.

How can she become a gold-standard country ? The obvious answer is, by introducing a gold currency. Prof. Kenyes scoffs at the view that there cannot be a gold standard without a gold currency as pure nonsense.* He seems to hold that a currency and a standard of value are two different things. Surely there he is wrong. Because a society needs a medium of exchange, a standard of value, and a store of value to sustain its economic life, it is positively erroneous to argue that these three functions can be performed by different instrumentalities. On the other hand, as Professor Davenport insists.†

“all the different uses of money are merely different aspects or emphasis of the intermediate function. Deferred payments are merely deferred payments of the intermediate. So again of the standard aspect; whatever is the general intermediate is by that fact the standard. The functions are not two, but one, Clearly, also, the intermediate may be a storehouse of purchasing power. The second half of the barter may be deferred. The intermediate is generalized purchasing power. Delay is one of the privileges which especially the intermediate function carries with it.”

Thus the rupee by reason of being the currency is also the standard of value. If we wish to make gold the standard of value in India we must introduce it into the currency of India. But it may be asked what difference could it make to the price level in India if gold were made a part of the Indian currency ? To answer this question it is necessary to lay bare the nature of the rupee currency. Now it will be granted that a standard of value which is capable of expansion as well as contraction is likely to be more stable than one which is incapable of (such a manipulation. The rupee currency is capable of)‡ easy expansion, but is not capable of easy contraction by reason of the fact that it is neither exportable nor meltable, nor is it

* Op. cit., p. 29.

† Op. cit., pp. 255-56 ; cf. also F. A. Walker, *Money in its Relation to Trade*, p. 27 ; and C M. Walsh, *The Fundamental Problem in Monetary Science*, p. 304.

‡The portion in the bracket is missing in the *Evolution of Provincial Finance*—Ed.

convertible at will. The effects of such a currency as compared with those of an exportable currency were well brought out by the late Hon. Mr. Gokhale in a speech in which he observed.*

“Now, what is the difference if you have an automatic self-adjusting currency, such as we may have with gold or we had with silver before the year 1893, and the kind of artificial currency that we have at present? Situated as India is you will always require, to meet the demands of trade, the coinage of a certain number of gold or silver pieces, as the case may be, during the export season, that is for six months in the year. When the export season is brisk money has to be sent into the interior to purchase commodities. That is a factor common to both situations, whether you have an artificial currency, as now, or a silver currency, as before 1893. But the difference is this. During the remaining six months of the slack season there is undoubtedly experienced a redundancy of currency, and under a self-adjusting automatic system there are three outlets for this redundancy to work itself off. The coins that are superfluous may either come back to the banks and to the coffers of Government, or they may be exported, or they may be melted by people for purposes of consumption for other wants. But where you have no self-adjusting and automatic currency, where the coin is an artificial token currency, such as our rupee is at the present moment, two out of three of these outlets are stopped. You cannot export the rupee without heavy loss, you cannot melt the rupee without heavy loss, and consequently the extra coins must return to the banks and coffers of the government or they must be absorbed by the people. In the latter case the situation is like that of a soil which is water-logged, which has no efficient drainage, and the moisture from which cannot be removed. In this country the facilities for banking are very inadequate, and therefore our money does not swiftly return back to the banks or Government Treasuries. Consequently, the extra money that is sent into the interior often gathers here and there like pools of water turning the whole soil into a marsh. I believe the fact cannot be gainsaid that the stopping of two outlets out of the three tends to raise prices by making the volume of currency redundant.”

Had gold formed a part of the Indian currency it would have not only met the needs for expansion but would have permitted

* *Supreme Legislative Council Proceedings*, Vol. L. p. 642.

contraction of *currency* in a degree unknown to the rupee. Gold would be superior to the rupee as a standard of value for the reason that the former is expansible as well as contractible, while the latter is only expansible but not contractible. This is merely to state in different language what has already been said previously, that the Indian monetary standard, instead of being a gold or a gold-exchange standard, is in all essentials an inconvertible rupee standard like the paper pound of the Bank Suspension period, and the extra local rise of prices which in itself an inconvertible proof of the identity of the two systems, is characteristic of both, is, to use the language of the Bullion Report*

“the effect of an excessive quantity of a circulating medium in a country which has adopted a currency not exportable to other countries, or not convertible at will into a coin which is exportable.”

Therefore, if some mitigation of the rise in the Indian price-level is desirable, then the most essential thing to do is to permit some form of “exportable” currency such as gold to be a counterpart of the Indian monetary system.

The Chamberlain Commission expended much ingenuity in making out a case against a gold currency in India.† The arguments it urged were: (1) Indian people will hoard gold and will not make it available in a crisis: (2) that India is too poor a country to maintain such an expensive money material as gold; (3) that the transactions of the Indian people are too small to permit of a gold circulation; and (4) paper convertible into rupees is the best form of currency for the people of India as being the most economical, and that the introduction of a gold currency will militate against the popularity of notes as well as of rupees. The bog of hoarding is an old one, and would really be an argument of some force if hoarding was something which knew no law. But the case is quite otherwise. Money, being the most saleable commodity and the least likely, in a well-ordered monetary system, to deteriorate in value during short periods, is hoarded continually by all people, i.e., treated as a store of value. But in treating it as a store of value the possessor

* Prof. Cannan's Reprint, p. 17.

† Report, pp. 15-19. The same arguments will be found in Chap. IV of Mr. Keynes's treatise.

of money is comparing the utilities he can get for the money, by disposing of it now, with those he believes he can get for it in the future, and if the highest present utility is not so great as the highest future utility, discounted for risk and time, he will hoard the money. On the other hand, he will not hoard the money if the present use was greater than the future use. That being so, it is difficult to understand why hoarding should be an objection to a gold currency for the Indian people. If they hoard gold that means they do not care to spend it on current purchases or that they have another form of currency which is inferior to gold and which they naturally like to part with first. On the other hand, if they do wish to make current purchases and have no other form of currency they cannot hoard gold. There are instances when precious metals have been exported from India, when occasion had called for it,* showing that the hoarding habit of the Indian peoples is not such an unknown quantity as is often supposed, and if on some occasions† they hoarded an exportable currency when they should have released it, it is not the fault of the people but of the currency system in which the component parts of the total stock of money are not equally good as a store of value. The argument from hoarding, if it is an argument, can be used against any people, and not particularly against the Indian people.

The second argument against a gold currency in India has no greater force than the first. If gold were to disappear from circulation then the cause can be nothing else but the over-issue of another kind of money. In the nineties, when the question of establishing a gold standard in India was being considered, some people used to point to the vain efforts made by Italy and the Austrian Empire to promote the circulation of gold. That their gold used to disappear is a fact, but it was not due to their poverty. It was due to their paper issues. Any country can maintain a gold currency provided it does not issue a cheaper substitute.

Again, if gold will not circulate because transactions are too small the proper conclusion is not that there should be no gold circulation but that the unit of currency should be small enough to meet the situation. The difficulties of circulation raises a problem of coinage. But the considerations in respect of coinage

*See the Memorandum by Mr. Dalai to the Chamberlain Commission Appendices, Vol. III, No. XXXIII, pp. 673-75, for this and other cognate topics.

† In the crisis of 1907-8 the Indian people were accused of this. Yet it must be noted that in that crisis some gold was exported on private account.

cannot be allowed to rule the question as to what should be the standard of value. If the sovereign does not circulate it cannot follow that India should not have a gold currency. It merely means that the sovereign is too large for circulation. The case, if at all there is one, is against the sovereign as a unit and not against the principle of a gold currency. If the sovereign is not small enough the conclusion is we must find some other coin to make the circulation of gold effective.

The fourth argument against a gold currency is one of fact, and can be neither proved nor disproved except by an appeal to evidence whether or not gold currency has the tendency ascribed to it. But we may ask, is there no danger in a system of currency composed of paper convertible into rupees? Will the paper have no effect on the value of the rupee? The Commission, if it at all considered that question, which is very doubtful, was perhaps persuaded by the view commonly held, that as the paper currency was convertible it could not affect the value or the purchasing power of the rupee. In holding this view it was wrong; for, the convertibility of paper currency to the extent it is uncovered does not prevent it from lowering the value of the unit of account into which it is convertible, because by competition it reduces the demand for the unit of account and thus brings about a fall in its value. Thus the paper, although economical as a currency, is a danger to the value of the rupee. This danger would have been of a limited character if the rupee had been freely convertible into gold. But the danger of a convertible paper currency to the value of a unit of account becomes as great as that of an inconvertible paper currency if that unit is not protected against being driven below the metal of ultimate redemption by free convertibility into that metal.* The rupee is not protected by such convertibility, and as the Commission did not want that it should be so protected it should have realized that it was as seriously jeopardizing the prospects of the rupee being maintained at par with commodities in general, and therefore with gold, by urging the extension of a paper currency, be it ever so perfectly convertible, as it could have done by making the paper altogether inconvertible. But so observed was the Commission with considerations of

* For an illuminating discussion on this topic, cf. *Money: Its Connection with Rising and Falling Prices*, by Prof. Cannan, 3rd ed., pp. 47-8.

economy and so reckless was it with considerations of stability of value, that it actually proposed a change in the basis of the Indian paper currency from a fixed issue system to that of a fixed proportion system.* That, at the dictates of considerations of economy, the Commission should have neglected to take account of this aspect of the question, is only one more evidence of the very perfunctory manner in which it has treated the whole question of stability of purchasing power so far as the Indian currency was concerned.

If there is any force in what has been urged above, then surely a gold currency is not a mere matter of "sentiment" and a "costly luxury," but a necessity dictated by the supreme interest of steadying the Indian standard of value, and thereby to some extent, however slight, safeguarding the welfare of the Indian people from the untoward consequences of a rising price-level.

We now see how very wrong the Chamberlain Commission was from every point of view in upholding the departure from the plan originally outlined by the Government of India and sanctioned by the Fowler Committee. But that raises the question: How did that ideal come to be so ruthlessly defeated? If the Fowler Committee had proposed that gold should be the currency of India, how is it that gold ceased to be the currency? It cannot be said that the door is closed against the entry of gold, for it has been declared legal tender. Speaking in the language of Prof. Fisher, the movement of gold in the money reservoir of India is allowed a much greater freedom so far as law is concerned than can be said of silver. Silver, in the form of rupees, is admitted by a very narrow valve which gives it an inlet into that reservoir, but there is no outlet provided for it. On the other hand, gold is admitted into the same reservoir by a pipe-connection which gives it an inlet as well as an outlet. Why, then, does not gold flow into the currency reservoir of India? A proper understanding on this question is the first step towards a return to the sound system proposed in 1898.

On an examination of the literature which attempts to deal with this aspect of the question, it will be found that two explanations are usually advanced to account for the non-entry of gold into the currency system of India. One of them is the sale of council bills by the Secretary of State. The effect of the sale of council bills, it is said, is to prevent gold from going to India. Mr. Subhedar, said to be an authority on Indian currency,

* Report, Sec. 112.

in his evidence before the Smith Committee (Q. 3,502), observed:—

“Since 1905 it has been the deliberate attempt of those who control our currency policy to prevent gold going to India and into circulation.”

The council bill has a history which goes back to the days of the East India Company.* The peculiar position of the Government of India, arising from the fact that it receives its revenues in India and is obliged to make payments in England, imposes upon it the necessity of making remittances from India to England. Ever since the days of the East India Company the policy has been to arrange for the remittance in such a way as to avoid the transmission of bullion. Three modes of making the remittance were open to the Directors of the East India Company: (1) sending bullion from India to England; (2) receiving money in England in return for bills on the Government of India; and (3) making advances to merchants in India for the purchase of goods consigned to the United Kingdom and repayable in England to the Court of Directors of the Company to whom the goods were hypothecated. Out of these it was on the last two that greater reliance was placed by them. In time the mode of remittance through hypothecation of goods was dropped” as introducing a vicious system of credit, and interfering with the ordinary course of trade.” The selling of bills on India survived as the fittest of all the three alternatives,† and was continued by the Secretary of State in Council—hence the name, council bill—when the Government of India was taken over by the Crown from the Company. In the hands of the Secretary of State the council bill has undergone some modifications. The sales as now effected are

* Cf. the Memorandum by Sir Henry Waterfield relating to the system of effecting remittances from India, Appendix to the Fowler Committee’s Report, p. 24; also memorandum by F. W. Newmarch on the Sale of Council Bills and Telegraphic Transfers. Appendices to the Interim Report of the Royal Commission on Indian Finance and Currency, Vol. I, No. VIII, p. 217.

† There was a fourth one, viz., the Government of India purchasing sterling bills in India on London and sending them to the Secretary of State for collection. It was employed for a short period of time in 1877, but was afterwards dropped.

weekly sales,* and are managed through the Bank of England, which issues an advertisement on every Wednesday on behalf of the Secretary of State for India, inviting tenders to be submitted on the following Wednesday for bills payable on demand by the Government of India either at Bombay, Madras, or Calcutta. The minimum fraction of a penny in the price at which tenders of bills are received has now† been fixed at $\frac{1}{32}$ nd of a penny. The council bill is no longer of one species as it used to be. On the other hand there are four classes of bills: (1) ordinary bills of exchange, sold every Wednesday, known as "*Councils*"; (2) telegraphic transfers, sold on Wednesdays, called shortly "*Transfers*"; ‡ (3) ordinary bills of exchange, sold on any day in the week excepting Wednesday, called "*Intermediates*"; and (4) telegraphic transfers, sold on any day excepting Wednesday, named "*Specials*." Now, in what way does the Secretary of State use his machinery of council bills to prevent gold from going to India? It is said that the price and the magnitude of the sale are so arranged that gold does not go to India. Before we examine to what extent this has defeated the policy of the Fowler Committee, the following figures (Tables LI and LII, pp. 579 and 582) are presented for purposes of elucidation.

From an examination of these tables two facts at once become clear. One is the enormous amount of council bills the Secretary of State sells. Before the closing of the Mints the sales of council bills moved closely with the magnitude of the home charges, and the actual drawings did not materially deviate from the amount estimated in the Budget. Since the closure of the Mints the drawings of the Secretary of State have not been governed purely by the needs of the Home Treasury. Since the closure, the Secretary of State has endeavoured§ :—

“(1) To draw from the Treasuries of the Government of India during the financial year the amount that is laid down in the Budget as necessary to carry out the Ways and Means programme of the year.

* From January 22, 1862, when the Sale of Council Bills under the authority of the Secretary of State first took place, up to November, 1862, the sales were effected monthly. From November, 1862, the sales were effected fortnightly; and in August, 1876, they were made weekly.

† From January to March, 1862, the minimum fraction was a farthing; it was reduced to $\frac{1}{8}$ th of a penny in March 1862, to $\frac{1}{16}$ th in January 1875, and to $\frac{1}{32}$ nd in 1882, at which fraction it has continued since then.

‡ First introduced in 1876.

§ Cf. Memorandum on the Sale of Council Bills, by F. W. Newmarch, to the Chamberlain Commission, App. Vol. I, No. VII. p. 222.

TABLE LI
BALANCE OF TRADE, COUNCIL DRAWINGS AND IMPORTS OF GOLD BEFORE 1893

Years.	Balance of Trade (Merchandise : Private Account).	Net Imports of Treasure.		Amount of Council-Bills drawn.	Excess (+) or Deficiency (—) of Bills drawn as compared with Budget with Estimate.	Home Charges.	Cash Balances in the Home Treasury.	Minimum Rate for Council Bills.
		Gold.	Silver.					
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1870-71	£ 20,863,000	£ 000,000 2.13	£ 000,000 .9	£ —	£ —	£ 10,031,261	£ 3,305,972	s. d. 1 10 ¹ / ₄
1871-72	31,094,000	3.43	6.3	—	—	9,703,235	2,821,091	1 10 ² / ₈
1872-73	23,376,000	2.41	.7	13,939,095	+ 939,095	10,248,605	2,998,444	1 10 ² / ₈
1873-74	21,160,000	1.29	2.3	13,285,678	- 214,322	9,310,926	2,013,638	1 9 ¹ / ₂
1874-75	20,137,000	1.73	4.3	10,841,615	+ 841,615	9,490,391	2,796,370	1 9 ³ / ₄
1875-76	19,204,000	1.40	1.4	12,389,613	-1,910,387	9,155,050	919,899	1 9
1876-77	23,573,000	.8	6.1	12,695,800	-964,200	13,851,296	2,713,967	1 6 ¹ / ₂
1877-78	23,758,000	.1	12.7	10,134,455	-2,115,545	14,048,350	1,076,657	1 8 ¹ / ₂
1878-79	23,167,000	.4	3.3	13,948,565	-3,051,435	13,851,296	1,117,925	1 6 ⁵ / ₈
1879-80	26,046,000	1.45	6.5	15,261,810	+ 261,810	14,547,664	2,270,107	1 7
1880-81	21,464,000	3.03	3.2	15,239,677	-1,660,323	14,418,986	4,127,749	1 7 ¹ / ₂
1881-82	32,855,000	4.02	4.5	18,412,429	+ 1,212,429	14,399,083	2,620,909	1 7 ³ / ₈
1882-83	31,389,000	4.01	6.1	15,120,521	- 221,479	14,101,262	3,429,874	1 7
1883-84	23,611,600	4.44	5.2	17,599,805	+ 1,299,805	15,030,195	4,113,221	1 7 ¹ / ₂
1884-85	20,034,100	3.76	5.8	13,758,909	-2,741,091	14,100,982	2,249,378	1 6 ³ / ₄
1885-86	21,344,200	2.10	8.8	10,292,692	-3,481,008	14,014,733	4,726,58	1 5 ¹ / ₂
1886-87	19,844,800	1.58	5.2	12,136,279	-1,195,121	14,409,949	5,280,829	1 4 ¹ / ₈
1887-88	18,724,400	2.10	6.5	15,358,577	- 891,423	15,389,065	5,900,697	1 4 ³ / ₈
1888-89	20,271,900	1.92	6.3	14,262,859	+ 262,859	14,983,221	3,259,933	1 4
1889-90	24,557,800	318	7.6	15,474,496	+ 784,596	14,848,923	5,402,873	1 4
1890-91	20,733,800	4.25	10.7	15,969,034	+ 980,034	15,568,875	3,885,050	1 4 ¹⁵ / ₁₆
1891-92	27,632,400	1.68	6.3	16,093,854	+ 93,854	15,874,699	4,122,626	1 3 ¹ / ₁₆
1892-93	29,287,300	1.75	8.0	16,532,215	- 467,785	16,334,541	12,268,388	1 2 ⁵ / ₈

“(2) To draw such further amounts as may be required to pay for purchases of silver bought for coinage purposes.

“(3) To draw such further amounts as an unexpectedly prosperous season may enable the Government to spare, to be used towards the reduction or avoidance of debt in England.

“(4) To sell additional bills and transfers to meet the convenience of trade.

“(5) To issue telegraphic transfers on India in payment for sovereigns which the Secretary of State has purchased in transit from Australia or from Egypt to India.”

The result of such drawings is that the councils are made to play an enormous part in the adjustment of the trade balance of India and the swelling of balances in the Home Treasury and the locking up of Indian funds in London. The second point to note in comparing the preceding tables is with regard to the price at which the Secretary of State makes his sales. Before the closure of the Mints the price of the council bills was beyond the control of the Secretary of State, who had therefore to accept the price offered by the highest bidder at the weekly sale of his bills. But it is objected that there is no reason why the Secretary of State should have continued the old practice of auctioning the rupee to the highest bidder when the closing of the Mints had given him the sole right of manufacturing it. Availing himself of his monopoly position, it is insisted, the Secretary of State should not have sold his bills below 1s. 4 $\frac{1}{8}$ d. or 1s. 4 $\frac{3}{32}$ d., which, under the ratio of 15 rupees to the sovereign, was for India the gold-import point. In practice the Secretary of State has willed away the benefit of his position, and has accepted tenders at rates below gold-import point, as may be seen from the minimum rates he has accepted for his bills.

It is said that if the council bills were sold in amounts required strictly for the purposes of the Home Treasury, and sold at a price not below gold-import point, gold would tend to be imported into India and would thus become part of the Indian currency media. As it is, the combined effect of the operations of the