

supposing that the closing of the Mints did not constitute an effective limitation on the volume of rupees in circulation, what was the remedy? Was the plan of a gold reserve to assure convertibility for foreign remittances calculated to promote that object if the gold reserve was to be got by coining more rupees? If the limitation of rupees was going to maintain their value, as it did the value of the shilling, was the permission to add to the volume of rupees which the Committee feared was overabundant if not redundant, for the sake of a gold reserve, designed to limit their volume?

It is difficult to read the report of the Fowler Committee without exasperation. The permission to coin rupees was mischievous in every way. It was destructive of a true gold standard; it was not wanted as a relief against monetary stringency, and was calculated to lower the value of the rupee. If it was anxious for a gold standard and currency, as it undoubtedly was, it should have absolutely stopped the coinage of rupees and suppressed the notification holding the government ready to give rupees for gold. In failing to do that it not only deprived the country of a sound system, but actually, albeit unwittingly, helped to place the entire Indian currency, including paper currency, on the basis- of an inconvertible rupee. Few people seem to be alive to the precise significance of that pernicious proviso introduced by the Herschell Committee, and remorselessly upheld by the Fowler Committee, that the government shall always be ready to give rupees for gold, but there can be no doubt that in the absence of a counter-proviso, requiring Government to give gold for rupees, the proviso is simply a cover for an authority to the Indian Government to issue inconvertible rupee currency of unlimited legal tender in the same way as the bank restriction was for an authority to the bank of England to issue inconvertible notes in unlimited quantities. The first step in the right direction would be to scrap that Report and make a speedy return to the safe and sound proposals of the Government of India as outlined in the despatch referred to above. The primary condition is to stop the coinage of rupees and not merely close the Mints to the public. Whether it would be necessary to melt a portion of the rupees depends upon what gold value it is desired the rupee should have. Once the total contraction of the rupee is

settled upon and all further coinage is stopped, India will be in a position to have an effective gold standard based on a free inflow and outflow of gold. There will be no necessity to reduce the rupee in legal tender and provide for its convertibility. Its value would be maintained intact by sheer force of its quantity being limited, provided the quantity in circulation has been reduced so far as to be always below the minimum demand.

Supporters of the existing system of rupee currency have ever since its inauguration held out that the currency is economical and secure. Its claim for security, both in terms of gold and commodities, has been tested, and the grounds of it have been analysed in the course of this and previous chapters, wherein is demonstrated how very much wanting it is in the essentials that go to make up a secure currency. We must now endeavour to assess whether it is economical, for if it were really so, then that might be a point of some value against its opponents. We must therefore scrutinize the economy effected by the rupee currency.

Kemmerer says,*

“ A convertible money finds its *raison d’être* largely in the fact that it economizes the precious metals, and makes possible a saving to the community. If paper money or token money are substituted for primary money, their substitution reduces the demand for the precious metals by the difference between the amount of metal used in the token money introduced plus that contained in the primary money required for the redemption fund. This economy of the precious metals results in an increased supply being thrown upon the market” [which supply goes abroad and into the arts and increases the non-monetary wealth of the country by an equivalent amount: the gold obtained for the metal economized represents a net gain to the community].

The same kind of gain, says Kemmerer, attaches to the use of inconvertible money, and even on a larger scale, because there is no necessity to use primary money even for a redemption fund, as there is when the money is convertible. Such views as these have led Prof. Keynes to opine that the Indian currency system is a marvel of economy, and that other

* Money and Credit Instruments in Relation to Prices, p. 63.

more advanced countries might usefully follow the lead. We will; not draw from this the uncharitable conclusion that either Prof. Kemmerer or Prof. Keynes would recommend that because an inconvertible paper currency is the most economical currency a country should adopt it without remorse. What we are concerned with is to find out whether the rupee currency is really economical. When the process by which the rupee comes into being is carefully analysed it becomes impossible to take seriously the plea that the Indian currency is economical. First of all, gold is tendered to the Secretary of State in London for his council bills, or gold is tendered to the Government of India in India in payment of taxes or otherwise. Out of this gold the Secretary of State buys silver and coins rupees. As the price of silver is below the ratio, there arises a difference between the cost price of the rupee and its selling price in gold. To the extent of this difference there is, of course, a gain. But this gain or profit on coinage, as it is called, is no benefit to society. It is a hoard, and to that extent represents a useless abstraction of wealth. If the profit is not to be used for any current purposes of society it is as well not to coin rupees. It is therefore obvious that so long as the profits are merely held apart from the revenue resources of India there is no economy in the rupee currency worth naming. From another standpoint the currency of India is a wasteful asset to society. Metallic currency is primarily a capital good representing a form of social investment. Consequently it is necessary to see that the capital value of the currency is maintained. It is a happy circumstance to note that the Government of India is not dead to this aspect of the question with regard to its paper-currency reserve, and has very recently instituted a depreciation fund for the preservation of its capital value.* Now, the considerations that apply to the paper currency should apply also to the rupee currency. Has the rupee currency maintained its capital value? The gold part of it, called the gold-standard reserve, is invested in interest-bearing securities. Interest is no doubt an additional source of gain, but have the securities maintained their capital value? Far from it. Turn to the rupee half of the currency. Has the bullion in the rupee maintained its capital value? There have been endless

* Cf. the Speech of the Finance Minister, Mr. Hailey, on the Indian Paper Currency (Amendment) Bill, dated September 16, 1920, *S.L.C.P.*, Vol. LIX, pp. 308-9.

charts and diagrams drawn by playful economists in which the black line, showing the nominal value of the rupee, has remained up while the red line, showing the bullion value of the rupee, has gone down with the falling gold value of silver. But what does that mean ? Simply that the rupee is a wasting asset and is not worth at a later date what it cost to society when it was manufactured. Surely there was more economy in the project of the mad Chinaman who burnt his house to roast his pig than there is in the Indian rupee currency? The Chinaman's house must have been *very* old and uninhabitable. The same cannot, however, be said of this converting of gold money into silver money, because we know that silver is an inferior kind of investment to gold. Thus viewed, the currency is not in the least economical. It appears to be so because people look only to the rupee. But, adding the cost of the rupee currency to that of the gold-standard reserve, can it be said that India would have required more gold if she had a gold currency in place of a rupee currency ? Bearing in mind that with a fixed limit on the issue of rupees there can be no reason for a gold reserve, the only result of a stoppage of rupee coinage would be that gold, instead of being, as now, part reserved as a sinking fund and part transmuted into a rupee currency, would enter into circulation without being subjected to this baneful and wasteful process.

No more gold would be required in the one case than in the other. We can therefore conclude without fear of challenge that with a complete stoppage of rupee coinage Indian currency would be truly economical, prices would be more stable, and exchange secure, in the only way in which it can really be said to be secure, and the rupee, although inconvertible, will cease to be a problem, which it has been ever since 1873.

But will that be all the advantage to the country ? By no means. In drawing a moral from his comparison of the paper pound of 1797 with the paper pound of 1914, Prof. Cannan* points out that—

“there can in these days be no doubt that the experiment of entrusting what no community should entrust to any institution, the power of creating money without limit, to the

* *The Paper Pound 0/1797—1821*, Introduction, p. xxxix.

Bank of England, compares very favourably with the modern plan of entrusting it to the Government itself or to a State bank completely under the control of the Government. In the comparatively short war of 1914-18 currencies 'not convertible at will into a coin which is exportable' were issued by Governments and Government banks in amounts compared with which the 100 per cent, increase in thirteen years, which made the Bullion Committee complain so vigorously in 1810, look absolutely trifling."

There was a time when it could have been said that this indictment did not apply to the Government of India. Few Governments could be said to have been so very anxious to wash their hands of the responsibilities involved in the management of a currency as the Government of India once was. In 1861, when the Government first undertook the issue of paper money in India, the anxiety it displayed was laudable. An impecunious Government, made prostrate by the heavy burdens of the Mutiny, should have welcomed the project of a paper currency as a source of profit. But so great was its sense of responsibility that the Government refused to be content with convertibility as a check on over-issue. One of the principal reasons why the desperate paper-currency scheme, which that straitened financier Mr. Wilson had devised in 1860 to find ways and means for improving the finances of India, was rejected was so well stated by his successor, Mr. Laing, that in these days of frenzied finance his remarks may as well be reproduced in full. He said* :—

"There was another important reason why he (Mr. Laing) thought that Sir Charles Wood's principle was the soundest. All parties were agreed that a paper currency ought to be identical with the metallic currency which it displaced. But the system of issuing against two-thirds of securities and one-third of specie, as was proposed by Mr. Wilson, would not always ensure this identity, and there was considerable risk that in times of buoyancy and speculation the circulation would be unduly extended. He thought that that was a point of considerable importance, because if we looked at what had taken place in India during the last three years, we should find a great increase in the wages of labour and the prices of commodities, which should warn us as to what the

* His speech on the Paper Currency Bill dated February 16, 1861, *S.L.C.P.*, Vol. VII, pp. 66—7.

consequences might be if we were to accelerate the process already going on so rapidly by any artificial inflation of the currency. If you unnaturally stimulated the rise of prices by an over-issue of paper circulation you ran considerable risk of changing the healthy action of commerce into a feverish excitement which was sure to bring about a reaction. If we continued to go on as we had done for the last two or three years, the result would be that many articles of Indian produce might be driven out of the market by the competition of other countries, and he therefore thought that the Government ought to be exceedingly cautious how it took any step that might unduly accelerate the tendency to a general advance, as might be the case under the system of paper currency which to any considerable extent represented securities and not bullion. Such an advance might even reach a point seriously embarrassing to the Government if the general rise in the rate of wages and cost of living made the present scale of salaries and the pay of troops no longer adequate.* For these reasons he thought it by far the wisest course to adhere to the principle of paper currency adopted in England as laid down in Sir Charles Wood's despatch."

Not only was the Government anxious to put a limit on the issue over and above making it convertible, but it did not want to be vested with the legal authority to issue notes. In a despatch dated April 27, 1859,† to the Secretary of State, the Government of the day observed :—

" We believe that the convertibility of the notes on demand would not be a sufficient guarantee against over-issue. When once the paper currency is established in public confidence, the temptation to take dangerous advantage of this confidence will be very great in a time of difficulty, if the power of doing so is left in the hands of the Government of India alone. Restriction by law, either to a certain amount of issue absolutely, or to any amount relative to the balances in India, will, in our opinion, be necessary. We think that such a law ought to be passed by Parliament, and not by the Legislative Council of India."

*During the bank suspension period in England it is to be noted that the Army and the Navy were paid in gold, for fear of causing discontent.

†For a copy of it, see Commons Paper 183, of 1860, p. 1.

Equally sane was the view of the Government in 1876 with regard to the rupee currency. The Bengal Chamber of Commerce, it will be recalled, had urged upon the Government of India to close the Mints to the free coinage of silver, without opening them to the free coinage of gold—a project which practically meant that the Government should undertake the management of the rupee currency. The reply of the Government of India was a sharp rebuke. It declared* :—

“8. . .the Chamber invite the Government to take a measure calculated to enhance indefinitely the value of the rupee by suspending the long-established legal right of all comers to have silver bullion manufactured upon uniform conditions under State supervision into legal-tender coin, and temporarily substituting a system of coinage at the discretion of the State.....

* * * * *

“11. It is essential to a sound system of currency that it be automatic. No man or body of men can ascertain whether at any particular moment the interests of the community as a whole require an increase or diminution of the currency; still less, how much increase or how much decrease is, at any moment, exactly needed. No Government which aspires to keep its currency in a sound condition would be justified in attempting that impossible task, or in leaving the community, even for a short interval, without a fixed metallic standard of value. Under an ‘open coinage system’ these things regulate themselves without official interference.”

Now, compare with this the later pronouncements of the government with regard to the principles governing the paper and rupee currency respectively. During the war, when the Government of India resorted to the enlargement of paper issues, Honourable Members of the Supreme Legislative Council pointed out the effects it would produce on prices in India. But the late Hon. Sir Wm. Meyer, who as a Finance

* Resolution of the Government of India, relating to the Depreciation in the Value of Silver, dated September 22, 1870, Commons Paper 449 of 1893.

Minister piloted the Indian finances during the last war, in the course of a speech on the Indian Paper Currency (Amendment) Bill, dated September 5, 1917, replied* :—

“ The note circulation was sixty crores before the war and is now about a hundred crores. But the Hon. Mr. Sarma shivered at the idea of inflation. I may remind him that one of the accepted (!) doctrines of economists is that artificial inflation of paper currency only exists when the note circulation is not fully covered. Now we have covered every rupee of our note circulation. in securities.....” [How could there be an inflation ?]

The change in the Government's view with regard to the rupee currency is equally noteworthy. In 1908, when the exchange value of the rupee fell below par, the Government was reminded that it was the result of the excessive coinage of rupees. But although in 1876 the Government did not think it was possible for it to so increase and decrease the currency to suit the needs of commerce, yet in 1908 the Government advanced the opposite view. The Finance Minister, the Hon. Mr. Baker, in his reply, went on to argue† :—

“ In the first place the whole of the new coinage that we have undertaken during this period has been undertaken solely to meet the demands of trade. Not one single rupee has been added to the circulation except to enable us to meet these demands.....”

Now, if it is dangerous to entrust a Government with the power to manage currency, how very dangerous is it to entrust it to the Government of India, which professes to carry out its trust on the basis of doctrines such as these ! No one is so ill-instructed in these days as to suppose that these are sound maxims. If security is enough, what need is there for convertibility ? If currency is issued only in response to trade demand, what fear is there of over-issue ? A Government acting on such a principle may well go on indefinitely increasing the currency without remorse. History abounds with instances of ruin caused by the management of currencies on such naive principles as these. ‡ Happily for the country, the paper currency profoundly

* S.L.C.P., Vol. LVI, p. 35.

† Cf. Financial Statement for 1908-9, p. 229.

‡ Cf. E. R. A. Seligman, *Currency Inflation and Public Debts*, New York, 1922, *passim*.

altered in its basis—one might almost say, tampered with—in 1920 by the Government is yet far away from currencies regulated on the theory enunciated by the Finance Minister. It is the rupee currency which has been, ever since the Mint closure, the chief source of danger to the welfare of the Indian people, particularly because of the principle governing its issue. Because that principle has the support, in itself a surprising thing, of such eminent authorities as Prof. Keynes,* Mr. Shirras.† and the Chamberlain Commission. ‡ it cannot alter the case for depriving the Government of this power of managing the rupee currency, for the principle is essentially unsound. The reason why the fallacy in the reasoning, that there could be no excess of rupees because of their being issued in response to trade demand, does not appear on the surface is due to the peculiar nature of money. Money is said to be wanted only because money has a purchasing power. That is no doubt true, but that does not quite explain why people so incessantly want money, even when they know that the value of money is so unstable. Indeed, if purchasing power was the only consideration we should not find such a desire for the current means of purchase. That desire can only be accounted for by the fact that money has a differential advantage over other goods, in that it has in the highest degree what Menger called the quality of saleability. That one can more often buy at a bargain than sell at a bargain is simply another way of stating that every one desires to hold his resources in the most saleable form of money. In this sense it is absolutely true that no more money can be issued than there is demand for. But from that it does not follow that there can be no over-issue of money purely for the currency needs at any given time. All money is acquired in response to trade or services, but all money is not retained in currency. Indeed, all commodities are exchanged for money, because money is supposed to bear the option of being used for non-monetary purposes. In the case of the rupee the option-of-use quality is non-existent. Consequently, although issued in response to trade demand, it remains in currency whether it is

* Op. Cit., p. 111.

† Op. cit., p. 39.

‡ Report, par. 66.

wanted or not, and thus tends to bring about its depreciation. That such a depreciation is possible cannot be denied even by those who maintain that rupees are issued only in response to trade demand, otherwise why should they be so very anxious for an increase of the gold reserves of the country. But the danger to the rupee currency does not merely arise from the possibility of indiscretion on the part of the Government. Besides the Government there have been statesmen in India so interested in the welfare of their fellow-subjects that they have rebuked the Government on several occasions for not making the profits on rupee coinage available for the advancement of the moral and material progress of the country.* and in 1907 the profits on rupees were actually employed in the extension of railways. It must fill every one with horror and despair to contemplate the consequences sure to emanate from the manipulation of currency for such ends. Is it not time this source of danger and temptation be removed by depriving the Government of this power to manage the rupee currency ? But what is the means of bringing this about ? If it is desirable to do away with the management then convertibility is an insufficient measure; for with convertibility the rupee will still remain a managed rupee. Only the complete stoppage of rupee coinage will remove the governmental interference in the management of Indian currency; and it is this that we must therefore ask for.

Queer as it may seem, SAFETY LIES IN AN INCONVERTIBLE *Rupee with a fixed limit of Issue.*

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* Such a sober politician as the late Mr. Gokhale took the lead in this matter. Cf. his speech in the Financial Statement for 1907-8, pp. 203-4 ; and the same indiscretion is repeated by Prof. V. G. Kale in his *Currency Reform in India*, 1919, p. 65.

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Book 4

