CHAPTER THREE: MONETARY MANAGEMENT AND THE SEASONAL CYCLE.

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Introduction

The demand for money in the inter-war economy was entirely dominated by seasonal agricultural operations. Short term finance generated by commercial crop movement, because the mainspring of capital generation accounting for an enormous share of the total investible funds in the agrarian economy. Hence, pressures that varied money supply, sprung from deep within the agrarian hinterland. They were dominated by, the frequency of seasonal harvests, the supply of coin, the availability of bullion, and rampant speculation on scarce commodities. It was the primitive topography of the seasonal economy that strongly influenced the application of money policy: this was the first determinant of money circulation.

The second determinant of money circulation was the Imperial insistence on the rupee exchange that powerfully influenced not the application, but the formulation of official money policy. Colonial development acted upon and re-ordered the backward agricultural economy, and attached the economy of the Indian sub-continent to the
world market and international trade. During the inter-war years the exchange policy of the Government manipulated the rupee to liquidate the recurrent positive balances of trade and service the priority of remittance. The Imperial connection and the breakdown of the Victorian economy gave the continuous flow of surplus through the rupee-sterling exchange, a determining influence over slack season money conditions in India.¹

The Government money policy operated in definite relation to both these constraints. Arbitrary changes in the agriculturists' preferences could warp money management, just as a drop in exchange could lead to a contraction of money supply. The Government could, of course, contract or expand currency to stabilise a temporary imbalance but, however, efficient the monetary technique these devices were only marginally effective in the inter-war economy.

There were, as a result, important problems both in the formulation and in the application of Government money policy. This chapter will investigate monetary management against the background of the enormous seasonal

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¹ As exchange was directly responsible for the expansions and contraction of currency, exchange fluctuation could create severe monetary imbalances. The money policy was designed to maintain a fixed exchange despite these fluctuations.
fluctuation in money stock. Each monetary initiative that sought to re-order currency imbalances, was a part of a well designed strategy to preserve exchange equilibrium in the slack season, and the smooth finance of crop in the busy season.\(^1\) The Imperial system benefited from India's positive trade balances, and required a smooth marketing of India's exports. The system was also committed to maintaining an irrevocable link between the rupee and sterling. As a consequence, between the busy season and the slack season, monetary management was a delicate operation that had to ensure a maximum of remittance, an efficient export of primary produce, and a guarantee of reasonable monetary balance. It was a juggler's act, much too complicated to work without frequent breakdown and temporary disorder.

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1. These were very important Imperial priorities that moderated the management of the seasonal economy. The rupee ratio and the availability of sterling remittance became an all-important concern at a time when export operations came to a halt. When the busy season commenced, it was no longer exchange equilibrium but a maximum favourable trade balance that was crucial for the Government guarantee of India's foreign obligations. Moreover, this favourable balance was important to maintain the viability of commercialised agricultural production, and thereby continue India's specialisation as a primary producer. It was vital, therefore, that money supply did not cripple the smooth flow of export trade. It was in pursuit of these priorities, that monetary management acquired the perspective and character that it did during the inter-war period. The two priorities often dictated conflicting currency policies.
Part I will analyse slack season management, at a time of the year when the rupee exchange weakened. The export of commodities usually came to a halt between April and September every year, and surplus rupees released from trade finance had to be contracted to maintain the weekly flow of remittance. Monetary directives of the Currency Department sought to re-impose, not so much money equilibrium but, under orders from the India Office, correct exchange imbalance. The preoccupation with exchange could grow so strong, that the monetary remedies complicated money conditions, generating disturbances which were amplified by primitive agricultural preferences, and wasteful currency habits. The consequences could be quite unexpected making it necessary to further contract or expand currency, by employing powerful tools that often made the remedy more frightful than the disease.

Part II explores the busy season expansion of currency that reversed monetary priorities. The currency department was now responsible for the efficient finance of crop, and the movement of agricultural staple from up-country to the urban trade centre. During the inter-war years, enormous investment flowed into institutional machinery specifically constructed to encourage trade finance, when a rapid expansion of currency was necessary. Bank expansion, credit facilities
to the Imperial Bank, and the increasing use of telegraphic transfers, were measures designed to increase the velocity of circulation and service the annual expansion of currency associated with the movement of export staple.

These reforms promoted the position that the Currency Department of the Imperial Bank played over trade finance, and coupled organised banking to an intimate functional relationship with indigenous credit. The enforced collaboration between the two systems of credit undertaken during the movement of agricultural staple, reinforced the position of the indigenous credit not as a parallel phenomenon, but a complementary structure that serviced the peasant's requirements of finance. This perpetuated the peasant's poverty, productivity suffered, investment continued to flow into money lending and trade, and as a consequence primitive currency habits persisted and interfered with the conduct of money management. Bullion, for instance, continued to service the agriculturists' demand for savings which could often precipitate a return, or an absorption of currency large enough to disturb monetary equilibrium. Despite sophisticated monetary controls, and the draconic will to contract or expand till results were achieved, money supply was determined ultimately by preferences beyond the control of organised credit.
A separate section explores some of the more prominent problems associated with the articulation of monetary directives. Since the influence of organised credit over money supply was limited, monetary instruments were not often strong enough to discipline an unpredictable economy. Part III has been divided into four sub-sections, each dealing with a property of the seasonal economy that varied money stock, and influenced the circulation of money through interest rates, velocity absorption and return and so on. Not only would such an exploration take us a step closer to a formal monetary definition of the seasonal economy, it also illustrates the extent to which the Government was willing to reach to preserve exchange equilibrium. The detailed monetary strategy followed the movement of crop to the trade ports, adjusting interest, contraction of currency, sale of Government securities, purchase of sterling, to maintain the equilibrium tied with the weekly remittances to the Secretary of State. This extraordinary effort not only bred consequences that were unmanageable, but what is more interesting is that no many understood that this was a result of a deliberate and sophisticated strategy. Piecemeal Reform could perhaps have corrected a faulty monetary mechanism worked only too well. The frequent breakdown of the systems of maintaining exchange equilibrium was only because the mechanism was pushed to limits that it was not designed for - the result was chaos.
The analysis that follows covers a month by month articulation of monetary policy, and serves to highlight the exchange debate that missed the point altogether. It was not a Gold Standard, a Gold Exchange Standard or even a Central Bank that could have helped, only a complete and final abrogation of sterling would have cured the country's erratic monetary pulse. The busy and slack arrangement season described in the following pages make it apparent that the ultimate official occupation was exchange or exchange equilibrium.
PART I

When Government accounts opened on the 1st of April, the start of the official year, the busy season had normally drawn to a close. If the movement of crops had been large and trade active, money rates would still be high and cash balances tight. Had the out-turn and value of crop been low there would have been an absence of stringency in the money markets, and a surplus of cash would have been rapidly collecting from up-country in the form of land revenue, or in exchange for bazar purchases.¹

These were not unimportant differences. The speed at which money returned to the urban trade centre, dictated the choice of monetary policy that the Government would employ to regulate the seasonal economy.² During the slack season when large funds returned from the finance of crop, an exchange equilibrium (Priority I) had to be maintained

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¹. Controller of Currency Records for relevant years. Under the heading 'Money Conditions', the Controller, in his report, described the abundance or stringency of money throughout the year.


"High-powered money may be regarded as an autonomous variable for two reasons. First, issue of high-powered money in India is determined by Government authority rather than any 'rule'. Second, authoritative determination of high-powered money to serve changing objectives of Indian monetary policy disrupted what otherwise might have been a rather close relationship between high-powered money, foreign trade balance, exchange rate etc."
and an outlet found for floating funds. Once the busy season commenced monetary priorities were reversed; the pressure on exchange normally eased, and equilibrium had now to be maintained in the complicated operations associated with the expansion of currency (Priority II).

Between the busy season and the slack season, Government monetary policy was required first to expand money supply and then contract money supply. Since an expansion and contraction had to be carried through consecutively, the Government monetary policy had to regulate the seasonal economy with precision; otherwise chaos would have been the result. Hence, between the necessity to ensure remittance to the Secretary of State, and the liability to maintain the operations associated with crop finance, the monetary policy pursued by the Government was really a delicate balance between money stringency and money abundance.¹

There were two possible alternatives that monetary authorities were faced with at the opening of an official year. The annual busy season could have been one of either:

- Case I - Active trade demand for money; or
- Case II - Slack trade demand for money.

¹ During the inter-war years, the monetary strategy that gradually evolved was designed to maintain this uneasy equilibrium. It was not always successful, but a pattern was established and with regard to the seasonal economy, this monetary strategy was decisively important to all related forms of commercial and industrial activity.
To deal with a Case I or a Case II situation, the Government in collaboration with the Imperial Bank could either expand or contract currency.¹

1. The monetary instruments at its command were evolved formally only after the First World War. To Expand currency, the Paper Currency Act of 1922 specifically permitted the Governor-General in Council to issue currency notes to the Imperial Bank upto ₹5 crores; a provision that was raised to ₹12 crores of freshly issued currency against bills of exchange tendered to the Imperial Bank. Detailed regulation issued on the 16 February 1922 laid down that:

1. The bills of exchange shall be internal bills or hundis drawn for trade purposes.

2. If the documents themselves did not bear any evidence of being drawn for such purposes the I.B.I. shall certify that to the best of its knowledge, the accommodation provided was for the furtherance of trade and not speculative activity.

3. No loan shall be made until the Bank rate rose to 6 per cent. The entire amount outstanding at any time shall bear interest at the Bank rate subject to a minimum limit of 6 per cent for the first 4 crores, and of 7 per cent for the subsequent 8 crores. Amount paid for stamp duty on bills were deductible.

4. The local Head Office of the I.B.I. at Calcutta would present the Controller of Currency with a demand currency promissory note, with a certificate to the effect that internal bills satisfied conditions under Section 20 Act amendment of Paper Currency Act, 1922.

Two years later in September 1924, the Government of India announced that as far as it might be necessary, they would use their powers to issue currency against Treasury Bills deposited in the Paper Currency Reserve in London and would, if necessary, introduce legislation to increase the...contd./
Slack Season: April-October

If trade demand was active, i.e., Case I, then monetary demand would be high and the circumstances would demand an expansion of currency.

(Footnote contd....)

legal unit of the holding of such securities in the P.C.R. There were additionally some provisions to modify the rate of interest at which these borrowings were allowed.

To Contract currency, provisions were evolved through custom and practice and were not legislated into effect as were the provisions to expand currency. The contraction of currency was a simpler process; the procedure involved the following:

1. Open Market Operation: By buying and selling securities in the open market, i.e. the annual Rupee Loan, or through weekly offers of Treasury Bills, the Imperial Bank of India could withdraw such huge sums of currency from circulation, that open market operations could directly effect money supply.

2. A contraction of currency could also be effected by controlling the exchange rate through the purchase or sale of sterling. A contraction of currency took place when the Government sold Reverse Councils to maintain the exchange value of the rupee in times of a weak exchange. Reverse Councils were cashed in London by means of the Paper Currency Reserve in England under control of the S.S.

3. Sterling Securities held in the Paper Currency Reserve in London were transferred to the cash balances of the S.S. for his ordinary requirements and notes to that extent were cancelled in India.

In 1923-24, though the usual winter demand for finance had ceased when the official year opened, the requirements for financing crops in Northern India were stimulated by the withdrawal of the embargo on the export of wheat.\textsuperscript{1} This caused a drain on the already low cash balances of the I.B.I; the sole source of crop finance.\textsuperscript{2} The result was that 'cash in hand' fell to 12.25 crores on the April 13, 1923.\textsuperscript{3} 11 crores was the operational minimum that the I.B.I. could work with and 12.25 crores in cash was uncomfortably close to this minimum requirement.

\begin{itemize}
\item[1.] However, the return of money from up-country was unusually slow and well into June/July of 1924 stringent money conditions provoked the C.C. to advise against further contraction.

"In April and May when money in the Calcutta and Bombay markets eased rapidly, the Imperial Bank was obliged to keep up its bank rate because cash slow in coming back from up-country. In fact, currency was short, though credit was plentiful."

D.O. from H. Denning, C.C., July 2, 1924.
File No. Accts & Fin, April 1924, Nos.57-117, Part A.

Current Notes: Trade and Finance, pp.79-80.

\item[3.] \textit{Capital}, April 19, 1923, p.923, Vol.LXX, June 1923,
Chapter on 'The Money Market'.
\end{itemize}
The Bank found it necessary to resort to a statutory loan of ₹2 crores from the currency department after the busy season was over.¹ This loan was not normally resorted to at a time of the year when trade demand was slackening, and money returning from up-country. The emergency provisions of the Paper Currency Act which allowed the loan of currency at stipulated rates of interest were used only when the return of currency was delayed and a critical deficiency developed in the cash position of the I.B.I.

However, the varying needs of operations associated with crop movement were at times unpredictable. Frequency of harvests, magnitude of revenue demand, the level of crop prices could seriously alter the magnitude of currency

¹ Similarly, April to June 1928 was a tight money situation because, as the Controller described it, "The Bank's cash is not rising at the rate which is normal at the end of April apparently on account of the continued demand for financing cotton in Bombay and the outflow of currency in the United Provinces for financing the rabi crop."

The Controller requested that he be allowed to expand currency, but was denied the permission as exchange was unusually healthy and a return of money from up-country was anticipated.


absorbed at the close of the busy season and generate unexpected money imbalances. Money expansion would become necessary to fuel trade demand, and exchange control would have to be temporarily abandoned.

Absorption of Currency and the Frequency of Seasonal Harvests

In a normal year, currency in the form of note and coin was absorbed till about 3/4th of the crop was marketed at about which time a return of currency set in as Government dues were realised from the cultivator. If the crop was late in ripening, money would flow back to the Government treasuries in payment of Government dues at earlier stages in the season. A delayed harvest of crop meant a smaller absorption of currency and a quicker velocity of circulation.

1. In essence, crop finance was determined by how rapidly stocks of commodities reached the trade port. In a particular year, the reasons for the rapidity or delay could be: (i) size of crop, (ii) prices, (iii) value of net import of gold and silver, (iv) amount of stored grain, (v) land revenue and so on.

2. Useful in unravelling the more difficult problems in crop finance.

See, 'Indian Central Banking Enquiry Committee 1929 Report', Vol.I, Part I, Chapter 'Role of Commercial Banks in Rural Finance.'
If the crop harvest was early in the season, absorption would be prolonged and the propensity to hold stocks till market prices rose would go up and velocity would fall. This is not to suggest that the Government does retarded or accelerated hoarding and the velocity of circulation. The trader-middleman could hold stocks of agricultural staple without reference to Government land dues.

1. "The only real indication of velocity is perhaps the cheque habit or the expansion of credit in the movement of commodities. Bills of trade and other forms of credit will fall under this category. However, despite the statistical evidence in muntas, cheques etc., there is no remarkable secular trend towards a general increase in velocity of circulation. Velocity, as other monetary variables, is seasonal in character."

See, Indian Central Banking Enquiry Committee 1929 Report, Vol. I, Part I, on the Cheque Habit. See also, B.M.S.

2. This is evident especially in the Provincial Banking Enquiry Commission Report.

Bengal Volume I, Report Volume on the Methods of Marketing; Indigenous Bankers and Money-lenders will serve as an example.

In a memorandum submitted by M.M.S. Gubbay to the Fin. Dept., he acknowledged the greater ability of the trader-middleman to hoard if he could be assured of a better return on his goods. In 1918, when the great war demand created a condition of rising prices, Gubbay wrote -

"Eventually the stocks will pass into the hands of the Bania, who being possessed of a certain amount, in certain cases a considerable amount, of capital, could without concern afford to hold up stocks against Government's knowledge that the demand for these commodities from Europe is so insistent as to make the question of price almost subsidiary."

However, this influence over the position of stocks multiplied the absorption or return of currency, specially when the overlap between a late season and an early realisation of Government dues was large enough to make hoarding widespread and confine the holding of stocks to the trader-middleman alone.¹

The absorption of currency was qualified by the agrarian economy in other important ways. The velocity of circulation, for instance, which had a direct bearing on money absorption, could at times be determined by the frequency of revenue demand just as easily as it could have been determined by crop prices. ²

In 1926-27, the very low percentage of absorption of currency was due to the heavy drop in the price of

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¹. See for land revenue and the general principles practised for assessment along with amounts realised at what times during the year.  
See Chapter on 'Present Method of Assessment', Cotton Areas only.

². In sharp contrast to an industrial economy where it is common to associate high rates of interest, rapidly rising prices with an increased velocity of circulation. In the seasonal economy the association between high prices and increased velocity was not as intimate.
cotton which left a small margin of profit with the cultivator. Receipts from sale of crop were used immediately for payment of land revenue or the repayment of advances made by money-lenders. As a direct consequence the velocity of circulation in the districts was increased, and a smaller import of new currency required. In certain areas of Berar, the Government had to partially suspend land revenue collection to enable cultivators to cover their agricultural expenses.

1. The Bombay Shroff Association telegraphed the Fin. Dept. to remind them of the general world depression -

"All the different lines of trade have been affected by the world depression, prices of almost every article have declined, movements of crops have been retarded and a feeling of the great uneasiness prevails."

The chief reason that aggravated the influence of the depression was the contraction of five crores on the eve of the busy season that created a good deal of nervousness and complicated the financing of crop movement during the busy season. This would have noticeably contributed to increased velocity and dehoarding, of commodities especially if it was anticipated that contraction would help depress prices.

See, Letter from Secretary, Bombay Shroff Association October 29, 1926 to F.D.

Also, Telegram from Secretary, Marwari Traders Association, November 12, 1926, File No. 72-F/1926.

2. Velocity was related to the seasonal movement of crops and to the demand for finance to market agricultural products. Prices in a seasonal economy are associated with export demand specially for commercial crop.
Conversely, high prices encouraged cultivators or merchant/middleman to hold stock, which normally increased absorption of currency and reduced the velocity of circulation. However, monetary consequences could be quite unexpected. In 1927-28 when high prices and an expectation of better profits encouraged cultivators to hold stocks of cotton,\(^1\) absorption was actually smaller than expected. The earlier than usual cotton crop was followed by an early groundnut crop, the prices of which were sufficient to meet the Government revenue demand. This strengthened the financial position of the cultivator and generated a confidence and a capacity to maintain cotton stocks that were in time disgorged.\(^2\) This was followed by absorption of currency associated with unloaded stocks of cotton, but this was reversed by a renewed revenue demand that had been deferred from 1926-27 and had to be repaid in 1927-28.

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1. High prices for cotton:
   - D.O. Denning C.C. to Fin. Dept., December 1, 1927.
   - D.O. Denning C.C. to Fin. Dept., December 6, 1927.
   - File No.5(VIII)N/1927.

Hence, land revenue demands and harvest conditions reduced absorption at a time when high prices would have normally meant increased demands for crop finance. Agrarian preferences and the demand for money could as a result be difficult to predict. Bullion demand was another such contingency that varied the circulation of money and disturbed monetary balance.  

Prosperity and the Demand for Gold and Silver Coin/Bullion

The money that was transferred up-country for financing commercial crop would return to the money market a month or two after the busy season in the form of land revenue; rates would thus ease, and stringency in the market would be replaced by plentiful funds. However, in times of prosperity, as in 1924-25, the agriculturist

1. The British Official never understood the peasants hunger for gold. Their principal excuse for the malfunctioning of the monetary system was because -

"India then is the world's Silas Marner and is likely to retain its insatiable appetite for gold until the population in the mass is educated upto the socially useful disposition of savings in interest yielding capital undertakings. The fact, however, that the development of sound banking and investment habits is a long process requiring infinite patience... adds to the difficulties of formulating a sound and generally acceptable monetary system to function smoothly and economically in existing circumstances."


2. "In India the progress towards normal conditions was more marked. For the 4th year in succession the monsoon was favourable. The rainfall for the period June to September was practically normal over the greater part of the country and was considerably in

....contd/.
with his more than normal profit, invested his surplus in bullion. The often large purchases of gold rapidly returned currency to the money market and generated easy money conditions often in times of an active trade demand for credit in 1924-25, the jute crop absorbed large amounts of finance, which returned from up-country because of bullion sales in November, and it was not until the cotton finance in early January 1925, that trade demand finally overtook the surplus currency released by sales of bullion. In fact, the currency authority released 6 crores of additional currency through the I.B.I. to overcome the stringency that had only temporarily been absorbed by bullion sales.¹ These bullion sales did at times of agricultural prosperity, form an alternative source of credit that released cash into the money markets,² lowering rates to levels well below the Bank rate.

(Footnote contd...)

excess in West U.P. and N.W.F.P. Rajputana and Malabar. The result was good harvest, exceptional agricultural prosperity and a large surplus of agricultural products for export."


2. The continuous depreciation of silver encouraged an enormous absorption of bullion silver, and a release of silver coin. As the fall in the price of silver continued, this tendency became accentuated, as each fall in the price enabled the owner of a silver coin to exchange this for fiduciary currency which would buy an increasing amount of pure, uncoined silver. This exchange would not have gone to the extent of tendering all silver rupees in circulation. A certain amount of rupee in silver coin was necessary for the normal transaction of commodities, and only those rupees kept as savings - that is hoarded - would have been so released for bullion silver in times of agricultural prosperity.

Memorandum by Mr Joseph Kitchen re: 'The Silver Situation'. File No.2(23)F/31.
Thus, if the season was prosperous, as the years 1923, 1924, and 1925 were, the cultivators' demand for bullion either in silver or gold to hoard as savings, quickened the return of currency to the urban trade centre. This return of currency made the use of the emergency provisions of the Paper Currency Act unnecessary, and the Bank rate could be allowed to fall, as greater and greater accumulations of cash collected at the Bank.

There could, however, occur a situation of rising bullion prices in which case coin was absorbed. This could create a net absorption of currency that could, at times of distress, be very large. A temporary financial stringency would develop with the attendant requirement of net expansion of currency.

1. This was particularly so in 1923 when the large imports of bullion tended to weaken exchange.

"The effect of this slight improvement in the export trade has, however, been counter-acted by large imports of bullion. The demand for gold from up-country during the past four months has been very steady. Bullion brokers at Bombay apparently anticipated that it will only last for another couple of months, when the present auspicious marriage season will come to an end. I am by no means convinced of the correctness of this. Our information from Northern India about the harvesting which is now going on of the exceptionally good wheat crop will result in further demands for bullion."

D.O. from E.M. Cook to C.H. Kisch, April 12, 1922, File Accts and Fin., May 1923, Nos. 60-126, Part A.

2. The war demand for rupees was enormous, and the arrangement with the U.S. Govt. for the purchase of silver under the provisions of the Pitman Act released 200,000,000 ounces in the form of silver rupees into the economy creating a massive net expansion of currency.

See, pamphlet by Francis H. Brownell 'Can India Co-operate in an Informal Stabilisation of Silver at no Fixed Ratio to Gold', file No. 2(23)F/1931.
There is an important feature that merits attention. Whether in coin or bullion the cultivators' preference for investing his savings in hoards of metallic value, had a bearing on the quantities of currency absorbed or returned from circulation. Could this feature possibly explain the negative correlation that is statistically quantified between farm income and the demand for money? The negative correlation was drawn for the years 1935-1950 by D. Biswas,¹ and can be interpreted to mean that for every rise of 100 crores in farm income there was a negative demand for money to the extent of 10 crores. This is a most unusual result, which Biswas himself is unable to explain satisfactorily. It is not reasonable to presume, as Biswas does, that in years of good harvest the cultivator bought land and the seller of land invested that money in time deposits. As time deposits do not enter Biswas's category of 'high-powered money', he concludes that a rise in farm income had a negative correlation of 0.0967 when measured against the demand for money.

Additionally, Biswas's reasoning is incorrect, because although land concentration was growing during the period, the seller of land was not a speculator on

land values, in touch with organised banking, but an impoverished landless labourer who used his additional income to service long-standing debts or for subsistence consumption. In no way can it be argued that money from the sale of land increased the volume of time deposits in organised banking.

More probably the drop in the mint value of coin, encouraged the demand of bullion rather than coin, especially after 1931, when the rupee went off the gold exchange and the price of bullion rose rapidly.¹ If so,

1. The resources freed by the tremendous export of gold since 1931, found amongst certain classes of agriculturists' scant opportunity for investment. Merwanjee and Sons, a Bombay firm of brokers, wrote to Osborne Smith to report that the huge efflux of gold -

"After having pushed Government securities up violently and made money nearly redundant in the market, as yet vast hoards must remain to be invested. The hoarders of gold were in vast majority not (among) those who normally buy investments on the Stock Exchange. To them the low price of silver after they have sold gold at the highest prices in living memory is a heaven sent opportunity. And they are likely to make good use of it."

Copy of a letter from Messrs Merwanjee and Sons Bombay Stock Bullion Exchange and Finance Brokers, to Sir Osborne Smith Gov, Reserve Bank of India, January 9, 1936, C.C. to F.D., File No.2(2)F/1936.

"There might, however, be a certain indirect influence from the improving trade conditions, and particularly from the strength of gold prices as higher sterling proceeds for their products and for their gold might stimulate Indian hoarders to increase their purchases of silver."

then it would not be out of place to suggest that the
demand for bullion, and the return of money to the urban
trade centre, must have accounted for the negative
correlation to a far greater extent than any incidental
investment in land.

If this hypothesis is accepted then the cultivators' preference for hoarding in coin and bullion, must play an
important part in what we may call, the monetary
properties of the seasonal economy. The large increase
in money supply between 1935 and 1950, must have, as has
been discussed, returned to the urban trade centre to
fuel either a rise in prices, or accelerate Bull or Bear
speculation on the demand and supply of export staple.¹

**Urban Speculation**

Very largely, political, social or economic
disturbances could at times upset trading on the exchange,

¹. "Money is first drawn away from the urban trade
centre by a rise in commodity prices, and returns
in such good years to purchase bullion."

See, Dharm Narain, 'Ratio of interchange between
agricultural and manufactured goods in relation
to capital formation in under-developed economies'.
and bull or bear speculation would develop altering money supply.\textsuperscript{1} The nervousness operated in deep background and seldom, except in times of acute political crisis, did it directly disturb stock-exchange trade and money supply.

Take, for instance, the cotton mill share market.\textsuperscript{2}

The Swadeshi movement in July 1922 was a catalyst strong

\footnotesize{\textsuperscript{1} Especially its much criticised policy towards the ratio. At times when the market suffered from excessive nervousness about the ability of the Government to hold ls6d, the smallest irregularity could lead to distrust of the Government and could alter money conditions damaging exchange. In 1930, the Government in accepting T.B. tenders at ls15d/16 a fraction under ls6d, precipitated a crisis in the money market. "This made the bazaar think that banks were doubtful as to our ability to maintain the ratio, and led to rumours both here (Calcutta) and in Bombay that 'Government had capitulated'. It is obvious that as a result of all the ratio talk, banks are reluctant to develop an open oversold position though it is, of course, absurd to suggest that they are developing an over-bought monsoon position." 


\textsuperscript{2} E.M. Cook (Secy. to G.O.I. FD) reported that though there was a distinct slump in industrial enterprises, the cotton mill industry continued to make profits because of the unusual rash of speculation that had made money available for re-investment in cotton shares. "There has, as usual, been a good deal of speculation there (Bombay) on this occasion in cotton mill shares, an influentially backed Government syndicate having cornered five well-known shares."

enough to have touched off active trading in cotton mills shares. Bull speculation and trading on an anticipation of rising prices of cotton mill shares was a direct consequence of the increase in the purchase of Indian mill-made cotton, and the larger profits that cotton mill-owners made as a result of the Swadeshi spirit during the Non-Convention Movement.

1. Paid-up capital of Joint Stock Companies at work 1920-21/1923-24:

<table>
<thead>
<tr>
<th></th>
<th>Cotton mills</th>
<th>Jute mills</th>
<th>Paper mills</th>
<th>Rice mills</th>
<th>Flour mills</th>
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2. Morrison Report: The more important corners, crisis etc. serious enough to merit intervention of the authorities.

**Cotton Mills:**

1921 - Mathurdas Gokuldas Syndicate cornered shares of Fazulbhoy Mills. Shares of Finlay Mills were subject to speculation and a corner captured by Mathurdas Gokuldas Syndicate.

1922 - Emboldened, Mathurdas Gokuldas attempted to corner shares in Kohinoor, David, Currim, Bharucha, Swadeshi and Nagpur mills. All cotton mills forward deals were arbitrarily stopped, prices fixed and the attempt failed. The Controller of Currency described the speculation as 'massive bull operations'. A corner took place in the shares of Currim and David Mills involved Sir Currimbhoy and E.D. Sassoon & Co.

All the above three bull operations took place on the cotton exchange.

In April of the same year (1922), money conditions were tight and there was no sign of the usual seasonal easing even well into the end of the month. Though the Imperial Bank returned a loan of two cores of rupees from currency on the 27th of April, the Bank rate did not fall from 7 per cent to 6 per cent till the 1st of June.¹

The prolongation of the period of tight money is difficult to explain, particularly as the demand for the finance of spring crops in Northern India was of a very short duration. There was a large issue of Treasury Bills by the Banks in March, made in anticipation of easy money in April, which could have squeezed the market, and

¹. This was all the more surprising because active trading on the share market had just overcome an uncertain response to stock trading because of the volatile political situation in 1920 and 1921. At that time the condition of nervousness was acute and money fought shy of Government securities. The C.C. reported that -

"On account of the political situation, business has been practically at a standstill all week. In the securities market, there has been practically nothing doing, and prices have been marked down, 3½ per cent paper falling yesterday to 65/8 though it is reported a little steadier here day. 1939-44 also fell, and I asked McDonald to make purchases on behalf of the depreciation fund.... The future depends on political developments, but at present every one is playing safe."

withdrawn more funds than had been expected. But this did not explain a demand for currency large enough to keep the Bank rate at 7 per cent throughout April and May.¹

No particular incident or speculation associated with a transitory commodity imbalance could have at that time, created a demand for liquidity large enough to have unnaturally tightened funds on the market.

¹ At times the Government's own currency policy could give rise to expectations that could result in bull speculation. In 1929, the collapse of the N.Y.S.E. eased money rates all over the world, and the Government was forced to float T.B.'s at a high interest rate during the month of August. The contractions of currency resulted in money being drawn into India, and sterling was tendered in quantities greater than normal. However, such a policy complicated the Government's treasury position and induced a bull tendency on exchange, allowing Banks to anticipate large sales of sterling in the cold weather and encouraging them to hold out for a better rate (for rupee) to the detriment of Government.

"As has been obvious throughout the season the exchange banks are heavily over-bought and with the steep gradation in forward rates exporters have been keeping their bills (export bills) bottled up until the last moment in fairly confident expectation... that they would be able to get a better spot rate."

This bull situation was undoubtedly catalysed by the general belief in the Government's greater need to purchase sterling and effect its remittances. The consequences of such an expectation, when general, could seriously alter money conditions on the exchange market.

D.O. from J.B. Taylor, August 26, 1929. File No.5(2)c/1929.
It was nervousness on the money market that was marked at this time. Lack of confidence in the 'Bazaar', due to the political situation, was further increased by the large budgetary deficits announced by the Government of India, and the vague anticipation of more serious financial trouble on account of the unusual exchange position.¹

To correct the imbalance, the I.B.I. retained a loan of 2 crores from currency which it had taken on the lst of March 1922. It was only in June, well into the middle of the slock season, that speculation died down and money returned, rapidly reducing the Bank rate, and allowing the loan from currency to be repaid on the lst of June.²

1. These are vital considerations when we consider the prevalence of forward transactions in the speculation and hoarding of agricultural commodities. These transactions would be upset if the demand for commodities dropped or rose rapidly, as the speculator would be in a position to lose large sums of cash. For evidence of forward dealings not only on the money market, but in the wholesale distribution of commercial crop, and at almost every well established mandi, see Radhakamal Mukherji, Chapter XIV Agricultural Marketing in Economic Problems of Modern India', Vol.I, p.309.

2. 'Capital', June 1, 1922, Vol. LXVIII, p.1182, 'Money Market'.
Falling Prices Bear Speculation

Consider in contrast an anticipation of falling prices and abundant money. Bear speculation, generated by an anticipation of falling prices, usually had the opposite effect on money stock and Government paper. 2

In April 1933, the steady drop in the level of prices of securities in London, including sterling bills of the Government of India, precipitated a crisis in the Bombay and Calcutta exchanges. 3

3.5 per cent Government paper


2. There were operators on the market who were as adept at encouraging speculation as the Government was in manipulating exchange. At times when political insecurity or financial disturbances agitated market conditions, speculators were particularly prone to bear, and at times bull trends. In 1929, the Yokohama Specie Bank was crafty enough to, at first, make a discreet offer to sell sterling at a favourable rate, and then withdraw when the Government appeared on the market to purchase, and re-sell when a distinct bear trend on the rupee was established. This was possible only because the stock market crash on the N.Y.S.E. was beginning to be felt all over the world, and falling prices, and reduced demand dried up India's annual earnings earned by her export trade; but nevertheless, the very fact that the Government could be quite easily embarrassed by such operations, demonstrates how tricky and sensitive the market had become because of the constant manipulation, to strengthen exchange.


was quoted at 88\(\frac{1}{4}\), but 3 months later, by June 1933, there was a substantial drop, the lowest point touching 79.5. This drop was recorded in the middle of the slack season (un-dated) and it is all the more surprising that the rupee paper was traded at such a low price when surplus funds usually flooded the market in search of accommodation at this time of the year.

What had occurred was, that the drop in prices had been intensified by bear speculation induced by a lack of confidence in the Government's ability to support its borrowings.\(^1\) This catalysed stock traders to unload their rupee loan certificates on the market. It was only after the Bombay Stock Exchange Association forbade forward dealing that prices of 3.5 per cent securities showed a gradual recovery and registered its normal popularity in February 1934.\(^2\)

\(^1\) H.L. Dholakhia, op.cit., p.207.

"It is a matter of common knowledge that the political development both national and international affected the price, often more than any other single factor." He gives a list of factors affecting the Bombay cotton market.

\(^2\) For Short History of Stock Exchange Regulation in India, see, H.L. Dholakhia, op.cit., pp.250-52.
There is no doubt that speculation had a powerful momentum of its own specially when Bear or Bull trends were strong enough to allow money market trading to snow-ball into a crisis not justified by commercial conditions.

The Stock Exchange 1931 and After

On the eve of the great depression in 1929, the shock to trade and prices caused by the collapse of the New York stock exchange reacted immediately on the Indian market and money rates eased at once.¹ The Government, not to let slack build up in the money market (generating an even greater weakness in exchange) raised their weekly offer of 3 months treasury bills from 50 lakhs to a crore on the 26th, simultaneously raising the rate of interest by gradual stages to 5.8 per cent. In a calculated policy to affect stagnant funds flooding the bazaar, they also announced an unlimited issue of 6 months bills with a yield of just over 5 per cent.

   Also, 'Fall in Commodity Prices' Memo by the Fin. Dept., File No.21(21F/1932.
The usual busy season had not at that time passed, and the market in anticipation of stringency in the near future made traders unwilling to invest too freely even in 3 month bills. As the absence of a trade demand began to be felt, there was a rush to invest in treasury bills, and the call rate jumped high enough to justify the money market's recourse to the Imperial Bank for short funds.¹

By January 1930, the heavy fall in the price of cotton, hessians² and, in fact, all India's export staples materially lessened the amount of finance required to move crops, and coupled with constantly maturing treasury bills, the market was well supplied with

1. J.B. Taylor admitted that in the year 1929-30
   "... we are controlling money rates by treasury bills and it would be absurd, even if it were possible, to let exchange drift about."

   D.O. from J.B. Taylor to Fin. Dept., January 8, 1930.
   File No.1(2)F/1930.


2. The S.S. advised the Fin. Dept. to postpone expansion as long as possible, and to issue T.B's to soak up currency and maintain exchange, though the Fin. Dept. did not react favourably, they advised raising the Bank rate as the supply of sterling was weak and uncertain. This was principally because -

   "... it seems unlikely from the way in which hessians and cotton prices are going, not to mention other raw materials, that expansion will be necessary within the next week or two."

   D.O. from J.B. Taylor to Fin. Dept., January 7, 1930.
   File No.1(2)F/1930.
funds. This over-supply of currency forced the Government to raise the rate on 3 month bills to 6.3 per cent, and later to a record 6.6 per cent to help keep the bank rate at its normal busy season high of 7 per cent.¹

What is interesting, however, was that in spite of the Government's anxiety to draw off funds, and in spite of the large funds chasing restricted investment opportunities in a time of acute depression, public confidence in the well-being of the Indian Government was shaky, and was ultimately responsible for the nervous market in Government securities.

By May 1931, any strength in the market had evaporated and prices of securities began to fall away.²


The exchange priority is particularly apparent; when Government securities were forced to decrease their issue price to draw off funds and maintain exchange at a time when interest rates in general, including gilt-edged rates in stock exchanges of the industrial world had crashed into abysmally low interest percentages.

2. The problem was relatively serious. The Controller of Cawnpore communiqué -

"I am told that some interested speculators have started a rumour in the bazaar that Government are likely to default in the matter of paying interest on our Treasury Bills. These speculators are trying to buy up the next due interests at a discount. It is unnecessary, of course, to point out how ridiculous this rumour is. I issued this communiqué to warn possessors of bills not to be duped and warn everyone that the circulation of a rumour of this nature is a punishable matter."

The enormous issue of Treasury Bills and the indebtedness of the GOI's liabilities precipitated this nervousness. The rumour was a lot truer than the Government itself would have liked to admit.

The lead being taken by India Sterling Bills on the London money market, the 3.5 per cent loan falling as much as Pound 7 within a week to Pound 53.¹ In India, 3.5 per cent rupee paper declined to Rs.5-12-0, and this drop was not, as in England, entirely due to slump conditions. The Civil Disobedience Movement had arrested trading in Government securities and speculators had shed away from Government bills at a time when the political future of the country was disturbed and uncertain. The announcement of the British Prime Minister, that India's credit would be supported by the British Government strengthened trade in securities but not for long.²


2. C.C. was anxious over the tone of the market and remarked that, 'Bombay knocked securities merrily all the week'. The Prime Minister's statement was unable to cure the nervous situation. "There is a tendency to dismiss the P.M's recent assurance as of no account in view of the different situation which has arisen at home since we gave it."


Bengal Chamber telegraphed the S.S. that only a further declaration by the National Government supporting the previous P.M's statement would cure the flight of capital and the unstable demand for remittance.

C.C. to Fin. Dept., September 16, 1931, Ibid.
Treasury Bonds were issued at 6.5 per cent in September 1931. The gold standard was abandoned in the same month, forwarded dealings were closed by the Bombay stock exchange in October, the emergency budget with its surcharge on income-tax was announced by the Finance Member. Through political uncertainty and weakness in trade, despite Government guarantees and restricted speculative activity, prices of securities dropped.¹ It was growing more and more difficult to support general public confidence in the credit-worthiness of the Indian Government. It was only in January 1932 when the Secretary of State re-paid a 5.5 per cent loan which had matured that month, that funds began to flow back into investment on gilt-edged government securities.

This fluctuation goes to show that despite minimal trade activity, bear and bull expectations were important in influencing the price of Government paper on stock exchanges. Normally, though the strength of such gilt-edged investment was unimpeachable, slump

¹. Controller of Currency wrote -

"In these circumstances we are convinced that a rise in the T.B. rates will not appreciably increase the amount of funds we obtain from the public. The present rates offer ample margin, if confidence were not lacking, and only re-establishment of confidence can improve the position."

Telegram to S.S., October 10, 1931.
File No.1(8)F/1931.
conditions and the reduced price of securities threw the influence of speculative trading into high contrast. In times of monetary imbalance stock market and money market trading were of critical importance. Speculative remittance, higher yield securities, political guarantees were only some of the penalties that the Government were forced to pay for or support on account of the seriousness of money disequilibrium caused by unstable exchange.

Case II

In contrast, consider an absence of stringency in money conditions. Money abundance normally inferred slack trade during the closing months of the busy season and a sluggish movement of crop.

In 1925-26, however, the absence of stringency on the money market was not so much the result of a severely reduced state of trade as of an over-supply of money at the urban trade centre. This over-supply

1. For small trade demand and excess currency the depression years are a standard example. 1929-30 effective contraction in April and May of 4 crores of rupees, combined with a floatation of 9 and 3 months' treasury bills prevented rates falling away too rapidly.

of cash was a rare occurrence that had been precipitated by:

(i) **Strong Exchange:** To the great satisfaction of the monetary authority the positive trade balances in 1923, 1924, and 1925 had released large sterling balances in favour of India. From September 1925 to February 1926, exchange was strong and in order to keep exchange from rising, the Government continually purchased large amounts of sterling. The result was that Exchange Banks

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**1.** The Fin. Dept. declared that the currency policy to deal with strong exchange would be to ultimately support an unlimited purchase of sterling:

"The idea was to raise our sterling purchases by stages as soon as exchange passed 1s6d to 1s63/16 at which rate we would make the purchases without limit of amount."

Exchange reached 1s6d on May 15, 1925, and between that date, and February 25, 1926, £46,317,000 worth of sterling was purchased by the GOI.

See, correspondence between S.S. and Fin. Dept., May/June 1925. File No.42-F/1925, pp.3-6, N.A.I.

**2.** The purchase of sterling was so large that the Managing Governors of the I.B.I. believed that it would be necessary to expand currency to an extent that they considered undesirable. At a meeting of the Central Board Committee of the I.B.I., the Controller of Currency reported that:

"They (I.B.I.) are rather concerned because I gather, that by increasing the currency we are preventing them from putting the Bank rate upto 6 per cent and thereby decreasing the profits of the Bank."


Also D.O. from Controller of Currency to Fin. Dept., November 5, 1925, File No.42-II-F/1925, N.A.I.

See also, 'Capital', March 4, 1926, Vol. LXXVI, p.515, Chapter on 'Exchange.'
could, at any time, put themselves in funds by selling to the Government and easing money conditions in the market.

The remittance priority of the Government had made an unlimited purchase of sterling necessary. This was a commitment that the Government had to stand by despite the serious inflationary pressures that such a prolonged purchase might have involved. The procedure was simple and direct. In order to obtain funds for the Government's large purchases of sterling, the I.B.I. credited to the Government balances, freshly issued currency. In 1925-26, the amount credited to the Government balances was in order of 9 crores, and was exactly equal to the amount of sterling offered for sale on tender by the exchange banks.

It will be noticed that this expansion of currency was the exact reverse of our Case I situation, when the remittance priority would have imposed an equally severe 'deflationary' handicap, had exchange weakened rather than strengthened. The Government would have been forced to set into motion a deflationary pressure, and initiate a contraction of currency rather than an expansion of currency to support exchange.
(ii) In 1925-26, as a direct result of a strong exchange, the prices of gold dropped. Relatively cheap silver bullion began to replace coin in hoards. Coins released from hoards were returned into circulation reducing the amounts of coin absorbed during the busy season of 1925-26. The return of currency swelled cash balances of the Imperial Bank and the problem of money abundance was further aggravated.

(iii) The short busy season was precipitated in the cotton areas by a 25 per cent drop in the price that export houses were prepared to pay for raw cotton. The result was that the amount of currency required for its finance was much less than in previous years.

Conditions (i) and (ii) were both circumstances that the usual monetary instruments of expansion and contraction could not control. This was not so much because the instruments themselves were ineffective, but because the

1. In 1919-20 when exchange rose above 2 shillings to 2s4d, had it not been for the gold import Act, the strong trade balances would have led to a demand for gold and reduced the high premium on the metal.


2. 'Gold', 'The Amount Absorbed in India', Vol. LXXV, 1925, p.617, 'Capital'.


3. 'Capital', Vol. LXXV, 1925, pp.472, 654, 815, 1014; Also, Cotton Crop First Forecast All India Capital, p.956.
priorities of monetary policy made their application difficult, if not impossible. In times of a strong exchange an inflationary pressure could not be regulated and conversely in times of a weak exchange, exchange control imposed a deflationary pressure on the stock of money.

In circumstance (ii), a strong exchange meant equally a fall in the price of bullion, varying the amounts of coin that the cultivator would replace with bullion. Once again the priority of 'exchange control' had side effects that were monetarily damaging.

Both (i) and (ii) had many implications. Since monetary management during the inter-war period was basically an amalgamation of busy season expansion and slack season contraction, there was no way of controlling money stock if exchange climbed above or below the upper or lower gold point.¹

¹ For instance, when in 1920 exchange climbed persistently above upper gold point because of the soaring price of silver, the persistent demand for remittance was in considerable excess of the supply of sterling. The export trade in India in the 1920's was turning into the post-war slump and the GOI had to contract vigorously to maintain the value of the silver rupee a policy that was doomed to failure as long as the international price of silver remained artificially high. Between February 1920 and August 1920, the contraction of currency was an unprecedented 23 crores of rupees, which decreased note circulation from 185 to 162 crores. This enormous deflation, among the most severe, had little effect on the divergence between the market rate for rupee and the rate at which Reserve Councils were then offered for sterling. It was only when the international price for silver dropped and the GOI stopped selling sterling that the situation returned to normal.

Even the Bank rate was entirely ineffective against an inflationary or deflationary situation as long as 'exchange control' remained the first priority of monetary policy. Abundant money was to become a troublesome consequence of low prices and slack trade in the years to come.

The only remedy that the monetary authority could resort to was to continuously contract currency creating a temporary scarcity of rupee to restore exchange equilibrium and facilitate remittance.

The most direct method by which a contraction of currency was undertaken was by withdrawing cash from the I.B.I. till the Bank rate strengthened. The new rate did control money abundance, but forced the I.B.I. to service its accounts at an inflated rate of interest.

This was not the only problem with the instruments of 'currency contraction'. In 1925-26 and in the subsequent year 1926-27, money conditions grew so easy that the Government was forced to contract upto 8 crores of rupees during the slack season.¹ Currency contraction during a

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In the slack season of 1926, (April, May, June and July), business was slack and the exchange market dull, not so much because of strong exchange but because of the general strike in England, the awaited recommendation of the Currency Commission, and the delayed rain in many parts of the country. Exchange in fact was weak, but the Government considered it wise not to pursue a strong course of contraction because it would have

...contd./-
time of strong exchange was next to impossible, because as in March 1925, the money market could re-supply a temporary stringency with funds by selling sterling to the Government. The contraction of 8 crores in March 1926, had no noticeable effect on the money situation.

The indirect method through open-market operation, and the selling of Treasury Bills was equally ineffective. Government securities in fact rose rapidly; 3.5 per cent paper rising from Rs.74.6-0 at the beginning of April to Rs.78.8-0 at the end of May, at which level it remained with minor fluctuations for the rest of the year.¹

Treasury Bills as a monetary remedy were not normally an efficient instrument in support of the Bank rate.² It

(Footnote contd...)

increased the 'sentimental' influence on exchange, especially since there was a condition of extreme ease in May-July of 1926 that would have demanded unusual measures subject to public criticism of manipulating exchange.

See, Telegram to SS, July 2, 1926, and Telegram from S.S. July 7, 1926. Correspondence between April and July 1926 in File No.72-F/1926, N.A.I., pp.1-10.


2. This was because Treasury Bills were not only an instrument used for exchange control, it was used also to support the Govt. requirements for cash to strengthen its Treasury position and as the Govt's revenue requirements were not always sympathetic to its remittance responsibilities. Treasury Bills were at best a compromise.


India Office did not want to see the GOI issue a large T.B. Notification as it would overload the F.D. liability to the money market and hamper exchange control.
was a marginal tool used at times when money imbalances were not acute. Its jurisdiction was the short loan market, which fluctuated seasonally along with the internal flow of agricultural finance. As a consequence, its saleability would suffer at times of the year when more attractive investment appeared on the market. This occurred on three occasions.

(1) Prior to the announcement of the rupee loan in June.¹ The rupee loan, announced during the quietest months of the slack season, were offered at very favourable terms

1. Another reason why T.B's were discontinued at least three months before the annual rupee loan, was because the loan usually satisfied Indian Treasury requirements, and to market T.B's for revenue purposes alone would enlarge the interest payments that the Government would have to guarantee to attract the funds in the money market. Additionally,

"Assuming that our loan is floated in the first week of August, the money we obtain from the issue of Treasury Bills now will be useless to us for the third month of the period for which the bills run in other words, we shall be paying interest for three months, on money we require for two months only."

At such times the F.D. resorted to ways and means advances which was an adjustment that involved only the Govt. and the I.B.I., and was not a formal recourse to the money market for funds.


However, the Fin. Dept.'s constant concern over their sterling purchases and exchange rates, often led them to continue issuing T.B's to maintain money rates and mop up 'redundant' cash. This was at the cost of the Indian Treasury and had to be borne to ensure remittances.
and regularly drew surplus funds off the money market. These long loans carried with them income-tax concessions, and a subscription of 26-28 crores of rupees would be over-subscribed within the space of a few days, often within a few hours of their announcement. Considered a highly attractive investment, the announcement of rupee loans invariably drew investable funds in such a large way that the price of other scrips and securities fell for want of bidders.

(2) Immediately before the commencement of the busy season in October: The flow of funds for the finance of crop, either cotton in Bombay, jute in Calcutta, or


Treasury Bills were issued for the first time on October 16, 1917. Originally, bills of 3 maturities 6, 9, 12 from Jan., 1918, 3 months bills were also introduced. Auction of Treasury Bills were held on Tuesday. A press communique was issued indicating inter alia the amount of the offer and the dates on which tender and payment were to be made. The sale could be stopped at any time without previous notice at the discretion of the Govt., and as the rates at which the bills were offered could be fixed in accordance with the requirement, the system afforded an elastic method of relieving the market of surplus funds, the largest amount of intermediaries sold was in 1931-32 for 126 crores:


The discount rates of the GOI Treasury Bills were in seasonal sympathy with other rates. The variation between the busy and slack season for 3 month bills could be from 3.5 per cent to 6.5 per cent, the minimum and maximum monthly average yields being 5.44 per cent and 7.23 per cent per annum.
rice in Rangoon, would swell to such proportions, that very little surplus currency would actually survive in the hands of those who had any to invest.\textsuperscript{1} The scarcity of funds, far more severe than before the annual rupee loan, discouraged buying and selling of 3 and 6 month Government treasury paper and trading came to a temporary stop forcing the price of bonds down, and hence the yield up.\textsuperscript{2}

\textsuperscript{1} This seasonal fluctuation in security prices on account of monetary factors is well illustrated in 'Stock Exchanges in India', K.L. Garg, p.105, Chapter 'Fluctuations in Security Prices'.

\textsuperscript{2} The Bombay Money Market, H.T. Parekh, Chapter 'Treasury Bills and Small Savings', pp.103-05.

There were, however, times when the issue of T.B's would be undertaken to ease the revenue position of the GOI, but if stringency was severe, then such an issue, even if attempted, was no reason why it would be successful. For instance, in September 1928, a weak treasury position forced GOI to notify 6 month bills, which were a dismal failure, even the I.B.I. was unwilling to subscribe to the notification.

"Banks being unwilling to lock up their funds until March next, take no interest in 6 month bills, and apparently I.B.I. put in no tenders in spite of Smith's statement... that Imperial Bank would be able by their tenders to keep down the rate at which T.B's would have to be issued."

The Controller felt that 3 month bills would suffer the same fate and the only solution was to float a sterling loan of Pound 7.5 million to ease the position.

Note by Shanker Rau and B.N. Mitra, November 2, 1928, File No.5(1)/F/1928, p.48.
D.O. Denning to Fin. Dept., November 1, 1928, File No.5(1)/F/1928, p.50.
(3) Scarcity lasted throughout the busy season, but as money returned from up-country when the payment of the land tax came due, the prices of securities rose again with surplus funds returning to the money markets.

There were unusual years when a large industrial scrip had to be undertaken and sales of Government securities were considered with a view of transferring the investment into a cotton mill, or whatever industrial scrip appeared on the stock exchange. The Treasury Bill, despite the normal preference for Government scrip, suffered quite markedly, as its capacity to attract funds was limited; it was as a consequence an uncertain monetary tool.

This inability to control money conditions by mere contraction or by open market operations reduced the effectiveness of the Bank rate as a monetary instrument. Undoubtedly, the Bank rate had some influence over the money market, if only because the Imperial Bank had the ability to withdraw from, and add to money circulation huge funds that would enforce its rate.\(^1\) However, its

\(^1\) This was exaggerated by the remittance priority that threw the ineffective Bank rate into sharp relief. Indian officials admitted that the Government's anxiety over exchange disturbed money conditions.

"... as there is always a period of some months in the slack season when the Bank rate is ineffective."

This was particularly so if the Govt. attempted to contract when export bills were in abundance, or when the money market could attract funds from sources other than the Imperial Bank.

Telegram from the S.S., February 8, 1929, Endorsement to C.C., February 11, 1929. C.C. to Fin. Dept., February 12, 1929, File No. 5(2) F/1929.

...contd./-
influence on indigenous credit and money-lending was negligible because of the sheer geographical impossibility of controlling rates in localities where the links with organised credit were at best, tenuous. This is not to suggest that the relationship between organised and indigenous credit did not exist altogether. The production of commercial crop was almost entirely financed by the money-lender. However, the distribution of the same crop from hinterland to port was moved by credit supplied mostly by the Imperial Bank. Hence, manipulation of the

(Footnote contd...)

Interest rates were distinctly divided into those controlled and manipulated by the indigenous money-lender, and those fixed by the Government money policy and the I.B.I. This had an important consequence in that the Bank rate could only act on prices in the Indian Economy in a circumspect and not entirely effective manner.


The contract between organised and indigenous credit is often personified in the urban sowcar and the town merchant.

"The town merchant gets his finance from the local shroff or from the commission agent in Bombay and in some cases from a local branch of the I.B.I., where such branches exist."

The town merchant is entirely responsible for the transport of cotton to the mill agent in an urban centre, perhaps even in Bombay. Bombay commission agents make advances on railway receipts, and are in turn financed by the I.B.I. and local Banks. It is at this level that organised credit first plays a significant part. The growth and initial marketing of the staple is entirely looked after by indigenous credit.
Bank rate could have to some degree influenced the price at which the export house could have bought the commercial crop, but it could have scarcely influenced the price of the same crop at up-country markets; or the price of the crop in the hands of the producer or middleman merchant. Though in some sense organised banking and indigenous money-lending activity could be found working together keeping the export economy functioning, they were essentially mutually exclusive categories with little control over each other.¹

More immediately, it is sufficient to grasp that the monetary remedies employed by the Government were not entirely without their problems. The degree of control over the regulation of money supply was not always effective or complete.

From April to June, slack season monetary management was faithful to the overall priority of remittance and the exchange equilibrium. We have seen that in the service of this priority, tactical methods were worked out to combat both a scarcity of money or a temporary abundance of money. Towards the middle of the

¹ The functional separation was marked. The agriculturist did not undertake activities associated with refining the crop i.e., ginning cotton and decortication of ground-nut. This was handled by the middleman after which he handed the crop from the gin-owner to the town merchant, shroff or commission agent.
calendar year, once the slack season had unavoidably set in, the monetary authority faced problems concerned with an abundance of funds. The problem of employing slack funds and drawing money off the market to improve exchange, grew most acute in June when exchange stability was at its weakest. It was at this time of the year when contraction was always pursued using both open market operations and the more direct, cancellation of currency.

June-July

By June-July, the slack season had unavoidably set in; a glance at the slack and busy season chart confirms the impression. There was not one commercial crop in India that was harvested and had to be moved for export during these two months.

Money collected rapidly in urban trade centres.
The Bank rate ebbed to its lowest point of the whole year. Money market rates would drop sympathetically, generating large surplus funds seeking opportunities of profitable employment.¹

¹ Slack funds meant a weak exchange, which at this time of the year was difficult to cure, what with the Government having abandoned T.B's and not as yet notified of the rupee loan. Remittances decreased and often came to a stop altogether, which encouraged the Secretary of State to act on his own by raising sterling on behalf of the Indian Government in London. There were three ways in which he could do this. If remittances had decreased, and the flow of sterling from the GOI had been acutely affected for many months of that year, a sterling loan of an extended maturity was undertaken. If the contingency was temporary the S of S could either float "India Bills", which were short-dated securities of 3, 6 or 9 months maturity, or he would borrow from the gold
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| Busy |           |           |           |
| Slack|           |           |           |
It was during the middle of the slack season that the annual rupee loan was announced, calling for funds that could total 30-32 crores of rupees. Despite the magnitude of the subscription that was received in both currency and bonds, a fresh issue could often be exhausted within two days, and on one occasion in two and a half hours. This large withdrawal of currency would hold the Bank rate from falling lower than 4 per cent.¹

(Footnote contd...)

standard reserve, which was a transaction accountable only to India Office who controlled the G.S.R. Indian officials preferred the second remedy, as temporary borrowing from G.S.R. did not transfer the responsibility to repay sterling to the GOI. India Bill was a public transaction equivalent to Treasury Bills in India, and merely postponed the demand for sterling inflated by the prevailing rates of interest charged by the London market. However, borrowing from G.S.R. was only possible if the India Office had not already pledged those securities in guarantee for any other transaction, in which case India Bills was the only answer.

See, Telegram to C of C, July 5, 1928.
Telegram to C of C, July 6, 1928.
Telegram to C of C, July 7, 1928.
Telegram from S of S to F.D., July 11, 1928.
Telegram from C of C to F.D., July 12, 1928,
File No.5(1)F/28, pp.24-25.

1. If by any chance the Govt. did not expect a large subscription, a widespread advertising campaign was initiated, as was done for the war loans of 1917 and 1918.

GOI Fin. Dept. 'Propaganda in connection with the Annual Rupee Loan', File No.13(XI)F/1928, N.A.I.

For operations and results of the Annual Rupee Loan, see report compiled by Controller and collected by Finance Branch, Fin. Dept., GOI held in N.A.I.
However, the anxiety with which surplus 'slack season' funds chased employment in long-term government securities was usually a result of a planned and well executed monetary policy.

I. If busy season stringency at the beginning of the official year evaporated rapidly, i.e. Case II in our scheme, then the Government would issue treasury bills before the rupee loan. This issue of treasury bills would contract currency; although in conditions of money abundance, only so many treasury bill notifications would be issued so as not to damage the rupee loan prospects, yet maintain exchange equilibrium between April and June.¹ Hence, treasury bills or Government short-term accommodation would only be used if an extra abundance of funds persisted


See, D.O. from J.W. Kelly D.C.C. May 1, 1929, File No. 5(2)F/1929.

"If loan is to have a chance, we should stop T.B's at least a month before it."

D.O. J.B. Taylor C.C., April 25, 1929, Ibid.
in weakening exchange;¹ in that case treasury bill contraction was a delicately used tool and had no significant effect on the rupee loan.

In 1930-31, during the depression years, the continuous need to draw surplus funds from the market, and to contract vigorously to counter-weight the low balance of trade was particularly apparent. General market conditions were by no means favourable. Trade was depressed, and a general lack of confidence in securities prevailed. The stock market, in particular, in Bombay was disorganised and dominated by political excitement. It was rumoured that an attempt would be made to boycott the annual rupee loan and a good deal of propaganda was spread encouraging investors to withhold their funds.²

1. If the export trade suffered from depressed commercial conditions and sluggish crop movement, then an active programme of contraction through T.B's could at certain times affect the subsequent years loan prospects. Uncertainty in the market could at such times breed a distrust of the loan, and thus depress prices of long-term Govt. securities. In 1928, the Controller explained that the poor response to that years' loan was because -

"The poor response to the loan of 1927 followed by the issue of large amounts of T.B's at high rates had been responsible for the drop in the price of Govt. securities, and uncertainty in the market as to the future trend in prices."


2. Memorandum originating from the Office of the Controller of Currency to the Fin. Dept. on Currency Policy from the beginning of June 1930. The C.C. wrote in this Memo:

"In view of the political situation and the general attitude of the commercial community, is it likely that we shall be able to float a rupee loan, with any hope of success at the end of July?"

In the same year, the extent to which the money situation was manipulated by the issue of treasury bills can be gauged from treasury notifications of 3, 6, and 9 month bills that preceded the rupee loan issue. 3 and 9 month bills were on offer to the extent of 2 crores weekly from the 1st of April to the 1st of July after which the 9-month bills were discontinued. The sale of 3-month bills was also suspended from the 23rd of July to the 11th of August to allow the rupee loan notification to be

1. J.B. Taylor wrote of the Currency Policy to maintain exchange:

"An essential part of this policy I consider to be steady contractions in June.... This will make the market realise that when trade revives, we will soon regain complete control of money rates. It may prejudicially affect the loan but that is a risk that must be faced."

_Ibid._, Part 3 Memo.

"To meet the contingency of the depression, the Government of India issued treasury bills in sizeable amounts and contracted high-powered money by Rs.370 million in 1930, Rs.391 million in 1931, by the sale of sterling which met by transfers from the Gold Standard Reserve to treasury balances of the Secretary of State. Prices started their downward course."

Ramana does not imply that the down trend in prices was entirely a result of contraction in high-powered money.

announced on the 20th July and completed by the 6th August. Total subscription realised was Rs.29,70,80,900. When the loan was announced prices of securities fell in adjustment to the yield of the new loan. This was unavoidable, but after the loan closed, a change came over the market. Prices of Government securities steadied and the new loan quickly went into a premium.

The disturbance caused by the rupee loan issue was not very material, and weekly offers of 3-month treasury bills were resumed with additions of 6-month bills from the 12th of August. The magnitudes involved reached 2 crores weekly. The average yields of the 3 classes of bills, i.e. 3, 6, and 9 month bills for the whole year were 5.25, 5.05, and 5.01 per cent, a near remarkable level considering average bill rates of the 1920 decade.

4. Ibid.  
5. Report of the Controller of Currency; J.W. Kelly, Offg. Controller of Currency, 1930-31, p.23. T.B's were freely used during the slack season of 1930: "Thus everything points to a heavy return of currency in the next four months and the only way in which it can be removed is by the free issue of T.B's." D.O. from J.B. Taylor February 26, 1930, Ibid.
The exchange position in the months of June, July, and August 1930-31 was so poor, that in addition to these sales currency was contracted during the year to the extent of 38\(\frac{2}{3}\) crores.\(^1\) The imbalance in exchange made it necessary for the Government to use all the three instruments of contraction to strengthen the rupee, and restore confidence in India's credit in London. These extreme measures could conceivably have had an important downward pressure on prices, exacerbating the effect of world-wide depression.\(^2\)

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2. An official remarked that what made exchange control so difficult in these years was that remittances from India were being used for attractive investments available on the European continent, and in America in low issue price official and semi-official loans. Indian capital was attracted by these investments, which was added to by repatriation of European capital from industrial concerns in Eastern India, that were gradually being transferred to Indian hands.

D.O. from Lindsay to Trade Commissioner, April 8, 1930. File No. 1(2)F/1930. Lindsay suggestions were drawn from an informal meeting with Sir Thomas Cato of Messrs Yule Cato and Co.
II. If busy-season stringency at the beginning of the official year was prolonged, i.e. Case I in our scheme, then Treasury Bill notification was delayed or postponed to well after the rupee loan.¹ However, unless the jute season (mid-September) was delayed, money abundance was cured by trade demand in the Calcutta circle by making treasury bills necessary in only the most difficult years. This leads us to monetary management in the third part of the slack season from August to October.

**August-October**

To prevent exceptional stringency from developing in the months of the Calcutta, jute-crop financing the monetary authority relied on provisions designed to

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¹. In April 1929, there was considerable apprehension expressed by the Fin. Dept. whether they would be able to obtain more than 10 crores of new money during the rupee loan scheduled in June-July of that year. The terms of the loan were to be made attractive, even though this might have meant a scaling down of prices of existing Government securities in the market. Contraction was to be abandoned as;

"... even if prices are cut, we do not consider that the loan will have a chance of success, if the market is apprehensive of continued contraction and heavy borrowing on T.B's. Our opinion, therefore, is that the loan should be floated as early as monetary conditions permit, possibly in June, and that we should avoid contraction."

Telegram to S.S., April 19, 1929. File No.5(2)F/1929.
expand currency, and increase circulation. Treasury Bill contraction was abandoned and the I.B.I. was allowed access to large Government funds at certain stipulated rates of interest. Further, new provisions were introduced in the Indian Paper Currency Act, authorising the issue of currency notes up to ₹5 crores against bills of exchange.

1. Jute crop estimates for the amounts of finance required for the current year.
   There were regular crop forecasts, stock position reports, mill profits, and exported quantities for every year in capital. The amounts required for finance of the crop can be roughly gauged from such figures.

2. This was ideally the case, however the Government's own treasury requirements often made it difficult to entirely abandon the issue of Treasury Bills in November, December, and January. Much to the displeasure of the India Office who believed that the greater short-term liability to the money market through outstanding treasury bills, the lesser the control that was possible over exchange. The Indian commercial community also disagreed with the issue of Treasury Bills in busy season, but for an entirely different reason. Treasury Bills during busy season tended to soak up currency, and this hampered expansions required for the finance of crop. Nevertheless despite protest from the India Office as well as the commercial community, the Fin. Dept. found it necessary to issue T.B's during busy season, however, an attempt was always made to keep issue of such bills to a minimum.

"... it would be necessary so, to strengthen our treasury position by issuing larger loans, or curtailing our capital requirements or both as to make it unnecessary for us to depend upon Treasury Bills as a means of tiding over even temporary difficulties."

However, this the GOI were not entirely prepared to do. D.O. Denning, September 7, 1928, File No.5(1)F/1928, p.36.

...contd./-
maturing within 90 days in order to meet requirements for an expansion of currency. The currency authority employed these expedients with the object of:

"... anticipating the preventing monetary stringency rather than relieving it after it had developed."

Thus, although the busy season did not really get going until October, enough money was made available for moving the jute crop, between August and early October. Despite this relative abundance, however, there was an unusual condition of money stringency during the years of the depression.

The Depression August-September 1931

The most serious expansion of currency was undertaken, surprisingly, at a time of the depression in 1931-32. The pattern of busy/slack season movement of funds would lead one to presume that a depression in the export-economy would retard internal trade, weaken exchange, reduce crop finance, and, given the Government commitment to support exchange, demand measures to severely contract currency. This is, indeed, what occurred in the first half of 1931. Owing to the fall in commodity prices and the slackness in trade the demand for

(Footnote contd...)

The I.O. suggested that the GOI draw on short funds during the slack season, "... desirability of Govt. placing itself in funds during slack season which would enable it to remain independent of Imperial Bank in busy season and would reduce its dependence on the market for short-term money as far as possible."

Telegram from S.S., August 9, 1929, File No.5(2)F/1929.
money was negligible. The only support to the money market was indeed the almost continuous issue of treasury bills. This continuous issue of treasury bills was not entirely sufficient in keeping the bank rate effective and in addition, large contractions of currency were made to prevent the cash balance of the I.B.I. from rising too high.¹

However, the two years of agricultural depression had eaten into the cultivator's normal profits, and in time hoards of bullion and coin were liquidated to pay for Government dues, and purchase of necessities.

The return of gold and silver from up-country was accelerated by the rise in the international price of bullion when rupee and sterling abandoned the gold standard.²

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¹ The reason was principally because the growing pressure to move funds out of India to invest in European and American securities, led the demand for remittance to increase. Coupled with weak trade and constantly maturing Treasury Bills sold at rates that had to be high enough to draw investment away from the non-Indian loans, the Bank rate was never quite in consonance with the prevailing abundance of funds.


² "The exports of gold from India were almost entirely from non-monetary sources. These exports were altogether different from an outflow of gold from the reserves of a Central Bank or from a treasury. The outflow of gold generally arises from a weakening exchange, but the exports of India's gold strengthened exchange."

This measure came into effect in September 1931 and rapidly devalued the rupee in terms of gold and the consequences on monetary equilibrium were enormous.

When the gold standard was abandoned, the Imperial Bank rate was raised to 8 per cent to keep in touch with the Bank of England rate which rose to 6 per cent. The banks throughout the country were closed for 3 days to prevent an anticipated run on funds.1 But the panic generated by the abandonment of the gold standard was so acute that when banks were re-opened on the 25th of September, the rate for call funds was quoted at 7 per cent, and there was a large outflow of currency which reduced the I.B.I. cash to an unprecedented 6.5 crores and necessitated their borrowing Rs.2.5 crores against internal bills of exchange.2

1. Telegram from C.C., September 21, 1931.
   Telegram from S.S. to Fin. Dept., September 21, 1931.
   File No.1(8)F/1931.

2. The large withdrawals of currency were exceptionally heavy in the Punjab and in Madras Presidency, and as late as the 9th of October, the out-go of funds had not appreciably eased.

"The position as regards cash is very peculiar and most disquieting. It is going out still in all circles although this is now the 9th of the month and it seems clear that a good deal of the money which was drawn out during the recent crisis will not return for a considerable time."

D.O. from J.W. Kelly C.C., October 9, 1931, File No.1(8)F/1931.
Within the short span of 15 days, the entire complexion of money conditions had changed. From a period of exceptional ease, money conditions had been transformed into one of exceptional stringency. The large volume of currency that had to be found for the finance of gold exports, coupled with the export of agricultural staple that grew nominally with the devaluation of the rupee, led to heavy withdrawals of funds. The Government of India was forced to expand currency to the tune of 50 crores during the remainder of the year.1 The Bank's cash position remained comparatively stable for the rest of the year, for only so much expansion was resorted to as would keep it at a reasonable figure.2

The depression years were years of monetary disequilibrium that justified extreme monetary measures. By 1933-34, though gold exports continued on as large a scale as before, other exports shrunk drastically and the Bank rate for the first time in the history of Indian currency settled at 3.5 per cent. It remained at that rate for the whole year, showing no seasonal fluctuation whatsoever.

1. Between September 1931 and February 1932, gold to the value of 50 crores was exported. F.I.C.C.I. estimated the amount of gold was Rs. 55 crores in the same period. See, FICCI Proceedings of the Fifth A.G.M. 1932, Resolution on Gold moved by Nalini Ranjan Sarkar, p.9. File No.1(8)F/1932.

Busy Season Expansion of Currency

In the years when monetary conditions were more normal, the annual busy season would begin around late September, early October. The jute finance in the Calcutta circle would peak during these months, following by the Broach and Khandesh cotton crop in December, rice in the Rangoon circle during January/February and the wheat and seed crops of the Punjab during February/March.

October-March

It was during this season that priorities of Government monetary management reversed. Exchange equilibrium was automatically assured at a time when large inputs of positive sterling balances were released through the export of agricultural staple. With exchange strong, the priority that governed monetary management now became the expansion of currency to facilitate the movement and export of crop. During the first five years after the war, the Government to ensure the smooth finance of commodity distribution, began to undertake infrastructural development that was specifically designed to promote internal trade and the export of primary produce.

Capital inputs in operational overheads for purposes of the transport of commodities were most extensive in the Railways and Telegraphs. But it was not just the development of transport and communication that catalysed commodity distribution; it was the technical improvements in the circulation of money and the multiplication of Banking operations in the hinterland that contributed substantially to the transfer of money related to the annual movement of staple.

These improvements in the sphere of the circulation of money consolidated the role of organised credit. The expansion of credit facilities after the inauguration of the Imperial Bank in 1921 encouraged the efficient supply of currency during the harvest and movement of crop. Thus by reducing the inefficiency in the process of circulation of money, this investment in operational overheads enlarged the profits that could be gained from commercial activity during the busy season.¹

¹ It is, however, significant that the huge capital expenditure incurred by the I.B.I. in setting up branches in British India, did not even partially destroy the position of indigenous credit in the countryside. The two structures of credit were complementary, and as a result, the development of institutional overheads encouraged a closer collaboration, a greater functional intimacy between indigenous money-lending and organised Banking.
Inland Remittance

Before the inauguration of the Imperial Bank of India, inland remittance of rupee funds for commercial purposes was a cumbersome task that entailed the actual physical movement of notes and coins from the urban trade centres to provincial towns. To lessen the unnecessary cost of transporting currency and bullion, a system of sub-treasuries was evolved and attached to local branch offices or newly opened branches of the I.B.I. Each sub-treasury had a certain reserve of notes and coins that was released or returned from circulation on orders from the local Head Office of the I.B.I.¹ The innovation was an important monetary facility. By distributing currency locked up in Central Treasuries to newly opened branches of the Imperial Bank, larger amounts of liquid funds were made available on demand at times when the busy season absorption of currency could grow acute.²

1. Imperial Bank of India Act, 1920, Schedule, pp.5-10.

2. 'Capital' wrote about the facility of currency chests:

"The total currency in circulation remains unaltered, but there is an improvement in the velocity of circulation."

The process by which the establishment of currency chests facilitated the economical disposal of Government and Imperial Bank balances requires a little explanation. Notes held in a currency chest were not in circulation, while coins held in a currency chest were a part of the reserve held by the Government against notes that were in circulation. A transfer, therefore, of an amount from the central treasury of the currency chest at a sub-treasury, enabled the corresponding transfer to be made at headquarters from currency to the Government balance at the Imperial Bank. ¹ This transfer was undertaken without increasing the total amount of notes in circulation beyond the coins, bullion and securities held by the Secretary of State and the Government of India, as it represented a subtraction of currency, exactly equivalent to the addition of currency authorised by a telegraphic transfer to a sub-treasury. When there were no currency chests at sub-treasuries, larger balances had to be kept in order to provide for all possible disbursements. During land revenue collection, these balances increased considerably because it was impossible to transfer them to headquarters without an actual remittance of coins and notes. ² Under

¹ For details, see 'Central Banking in India - 1773-1934', Om Prakash Gupta, pp.53-55. See also, Ramachandra Rau, 'Present Day Banking in India', pp.193-97.

the new arrangement, a telegram to headquarters informing the Central Treasury that a transfer to the currency chest had been made, enabled surplus funds collected at a sub-treasury to be brought into use at once. All the Head Office was required to do was to issue money at the trade centre knowing that an equal amount had been withdrawn from circulation in a currency chest at a sub-treasury.¹

The extension of this system of currency chests increased the velocity of the circulation of currency, particularly at times when staple crops were brought into the market.² The portion of additional currency sent up-country for the financing of crops, which was used by the cultivator to pay land revenue and other Government dues, was promptly released at the trade centre, instead of lying about uselessly for two to three months in transit between locality and headquarters. During the year 1921 alone, the number of currency chests opened were 143 against a total of 342. The number climbed to 892 in 1922-23.³


2. 'Present Day Banking in India', Ramachandra Rau, Chapter on 'Imperial Bank and its Achievements', p.201.

It was such institutional developments in the circulation of money that increased the efficiency of the annual expansion of currency.

Bank Expansion

Bank expansion, mentioned earlier, is a case in point. With the inauguration of the Imperial Bank of India in 1921, the Government laid down a stipulation making branch expansion of the Bank a mandatory procedure.¹ The Governors of the Bank were directed to open branches in localities where the introduction of credit facilities would directly benefit inland trade and commercial activity. Branch expansion between 1921-1926 followed these guidelines very closely.²

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1. Imperial Bank of India Bill 1920,

"That within five years from the commencement of Act, the Bank shall establish and maintain not less than one hundred new branches, the location of at least 1/4 of which shall be decided by the Governor General in Council."


2. Bank expansion was clearly designed to spread the movement of money so as to catalyse the speedy expansion of currency for trade and Inland remittance. The question was discussed by the Finance Member (Hailey) with Secretaries of the three Presidency Banks at a conference in August/September 1920. Malcolm Hailey felt that:

"The advice of the local Governments with particular reference to the population, the trade and financial and commercial activities of any particular locality or of its importance in any other respect (specifically as a military cantonment) must be a most important factor in the selection of localities where the Imperial Bank should open."

...contd./-
Existing branches were exploited more fully, and where the bank opened new branches there was little doubt that the five big up-country centres of trade (Jahore, Delhi, Amritsar, Lucknow, and Kanpur) and the four great ports of India (Bombay, Calcutta, Madras and Rangoon) received the most attention. As late as 1916 about 32 per cent of the total head offices and branches of all banks in India were concentrated in these four places. By 1936, the percentage of offices of all banks in the nine towns dropped to 16 percent.¹

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(Footnote contd...)

D.O. from M.S. Gubbay (Secy. to Fin. Dept.) to financial Secretaries of all local Governments, September 15, 1920.

Also D.O. from C.L. French (Fin. Secy. to Punjab Govt.) to Secy. Fin. Dept., October 13, 1920.

File. Acc. etc. February 27-30: Part B/1921, N.A.I.

Also File. Acc. etc., October 549-535: Part B/1923, N.A.I.


¹. S.K. Muranjian, 'Modern Banking in India', Chapter II, p.16.
Banking facilities\(^1\) were thus extended to the interior of the country.\(^2\) The Imperial Bank was thereby able to finance movements of agricultural produce, internal trade, inland exchange and remittance operations, which allowed the Bank to exercise a greater control over the expansion of currency.

By 1926, when the growth of the Imperial Bank was stemmed and then officially discontinued policy emphasis shifted from opening new branches to the consolidation

1. See, Central Provinces and Berar Provincial Banking Enquiry Report which states explicitly on the functions of the I.B.I.

"It would not be possible for these ten branches to take an appreciable part in financing the needs of the individual cultivator, and as a matter of fact, the banks take no part in the direct financing of agriculture, being prohibited by law from advancing money on the security of land.... It will be correct to say that its business outside Government banking is at present confined to taking part in the financing of trade, the marketing of crop, the movement of produce and remittance"


and strengthening of existing credit facilities. A spokesman of the Central Bank of India complained in 1931 to the Central Banking Enquiry Commission that:

"... the remarkable pity of the present situation is that branches are not established in places which do not possess banking facilities, but only in district capitals, populous towns and the chief monetary centres, where banks already exist."

A persistent complaint tendered by the Indian Joint Stock Banks was that the I.B.I., by opening credit facilities where the joint stock banks maintained their own branches, increased competition, and reduced the utility of total resources allocated for the creation of credit facilities for the cultivator. What did occur

   See also, Om Prakash Gupta, op.cit., p.62.

2. The question was raised in the Legislative Assembly:
   "The vast and scattered population of India, has thus modern banking facilities at 165 stations only, and consequently the financial power of India is insufficiently mobilised. Money lies dormant in endless small hoards."

The Finance Member, W.M. Hailey's reply was that the Bank can prove to be a national asset if it is able to consolidate its resources and not fritter it away on mechanical multiplication of Bank branches. The primary object, said Hailey, was to lessen the use of coin and note by the efficient remittance of money where it is most urgently required.

Extract from proceedings of Indian Legislative Council, September 8, 1920, at the Viceregal Lodge in Simla (5 and 6 Geo. V Chapter 61) amendment move by Rai Sahib Seth Nathmal.

In 1921, R.D. Tata made a suggestion that urged that new branches of the Imperial Bank should only be opened in places where adequate banking facilities do not exist.

was that with the expansion of the Imperial Bank, and the enormous influence of the currency department, its branches must have facilitated the drawing of surpluses from rural districts to the urban centres. The preponderant position of the bank, and its practical monopoly over trade finance sharpened the direct competition with Indian Joint Stock Banks. The ultimate result was that Bank expansion made the movement of agricultural staple more efficient, and by streamlining trade finance, strengthened the seasonal momentum of currency.

This is all the more evident in the reforms that were undertaken by the Finance Department to assist the I.B.I., in facilitating crop finance. Reforms

1. 'Inland Drain' as talked about by Dadabhai Naoroji:
   "The unilateral transfer of funds from rural-urban India arrested capital formation in rural areas."
   See also, B.N. Ganguli on the Drain Theory of Dadabhai Naoroji.

   Written Evidence, pp.1-67, Question No.16 and 17 of the Official Questionnaire.

3. 'Public Deposits', See, Om Prakash Gupta, op.cit., p.66, Public Deposits with the Imperial Bank of India.
that were designed to increase the capacity of the
Imperial Bank to handle the seasonal oscillation and
minimise the more extreme fluctuations generated, rather
than eliminate them altogether. The close co-operation
between the Government and the Imperial Bank, and the
Bank's interest-free use of the huge Government balances,
assisted the annual movements of funds in an important way.

In the winter of 1923-24, a fairly typical
busy season sequence with active trade demand, the
Government deposits with the I.B.I. stood higher than the
cash balance of the Bank. As these deposits amounted to
22.5 crores at the end of February, 27 crores at the end
of March, 18 crores at the end of April, and over 20 crores
at the end of May and June, the money position in the
latter part of the busy season of 1924 was materially
assisted by these large deposits which the Government left
with the Bank.¹

¹. Om Prakash Gupta, op.cit., p.66.
See also, Appendices to the Report of the Royal
Commission on Indian Currency and Finance

Report of the Controller of Currency 1928-29,
1931-32, and 1932-33, pp.41 and 57.

Statistical Tables relating to Banks in India -
Banking Monetary Statistics.
Surplus deposit was only one of the many ways in which the Government assisted the I.B.I. in maintaining the finance of trade. The Chamberlain Commission and the Babington Smith Committee proposed a series of measures from the issue of additional currency backed by hundis, and the Government's own sterling investments, to the amendment of the Indian Paper Currency Act, to allow the amendment of the Indian Paper Currency Act, to allow the Bank to borrow cash at beneficial rates of interest during the busy season.

The busy season operation of adequate and timely expansion of credit was made possible only because of the institutional machinery of the currency department.

**Busy Season Expansion: A Statistical Study**

The actual operations associated with crop finance can be described by taking the case of the Deccan cotton crops. In view of the area's proximity to Bombay, the

---

1. The information on institutional arrangements designed to expand currency, transfer coin and note up-country was first collected when H. Denning was Deputy Controller of Currency, Bombay. The reports issued, dealt in detail with Khandesh, Central Provinces and Berar designated by the East India Cotton Association as Area I. Area II classed as Central India, Barsi Nagar and districts adjacent to Berar, came under the jurisdiction of the Deputy Controller of Currency, Northern India. It was not till 1922-23 that figures were collected and compiled for the cotton hinterland, i.e. Area I and Area II.
headquarters of the Imperial Bank and the Controller of Currency, the cotton crop finance drew a good degree of attention in the form of statistical information and writing of area reports.1

According to figures supplied by native private agencies in the area, the approximate out turn and value of the cotton produced in the area between 1921-22 and 1933-34 are shown in Table 1, compiled from Appendices to Controller of Currency Reports.2 The figures give the value of cotton in the up-country markets, thus represented the actual amount of cash paid out.

The cotton hinterland contained only one or two banks besides the branches of the Imperial Bank at Nagpur, Akola, Amraoti, Jalgaon and Dhulia.3 The greater

---


2. Appendices to Controller of Currency Reports from 1920-21 to 1933-34 had figures as quoted on crop finance. However, they were not always consistent; the Controller published figures on cotton and jute, but for rice, figures were produced only intermittently.

3. There were ten branches of the I.B.I. in the province, four in Berar and six in C.P.
   Amraoti, Akola, Yeotmal, Khamgaon, Nagpur, Wardha, and Khandwa are all situated in the cotton zone. Jubbulpore and Katni area in the wheat zone. Raipur in the rice zone.
   The plateau had no branches of the I.B.I.
**TABLE ONE**

**COTTON**

Value (00,000)

<table>
<thead>
<tr>
<th>Area</th>
<th>1921-22</th>
<th>1922-23</th>
<th>1923-24</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BALFS</td>
<td>Value</td>
<td>Bales</td>
</tr>
<tr>
<td>I</td>
<td>1675000</td>
<td>2880</td>
<td>1473000</td>
</tr>
<tr>
<td>II</td>
<td>1005000</td>
<td>1866</td>
<td>898000</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Area</th>
<th>1924-25</th>
<th>1925-26</th>
<th>1926-27</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BALFS</td>
<td>Value</td>
<td>Bales</td>
</tr>
<tr>
<td>I</td>
<td>1211000</td>
<td>2755</td>
<td>1164000</td>
</tr>
<tr>
<td>II</td>
<td>813000</td>
<td>1819</td>
<td>890000</td>
</tr>
<tr>
<td>Total</td>
<td></td>
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<td></td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Area</th>
<th>1927-28</th>
<th>1928-29</th>
<th>1929-30</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BALFS</td>
<td>Value</td>
<td>Bales</td>
</tr>
<tr>
<td>I</td>
<td>1365400</td>
<td>2303</td>
<td>1549000</td>
</tr>
<tr>
<td>II</td>
<td>961500</td>
<td>1649</td>
<td>950000</td>
</tr>
<tr>
<td>Total</td>
<td>2326900</td>
<td>3952</td>
<td>2489000</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Area</th>
<th>1930-31</th>
<th>1931-32</th>
<th>1932-33</th>
<th>1933-34</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BALFS</td>
<td>Value</td>
<td>Bales</td>
<td>Value</td>
</tr>
<tr>
<td>I</td>
<td>1470500</td>
<td>1170</td>
<td>570000</td>
<td>573</td>
</tr>
<tr>
<td>II</td>
<td>926000</td>
<td>728</td>
<td>488000</td>
<td>482</td>
</tr>
<tr>
<td>Total</td>
<td>2396000</td>
<td>1898</td>
<td>1058000</td>
<td>1055</td>
</tr>
</tbody>
</table>
part of the money for the financing of the cotton crop from 1921-22\(^1\) onwards was provided by these branches and by Government telegraphic transfer from Bombay on the treasuries and sub-treasuries in the area. In addition, large quantities of rupees were "raised up" from Bombay by the local shroffs, and notes were imported by private agencies.

From statistics kept at the Bombay currency offices\(^2\) of the destination of all large issues of rupees, it is possible to obtain a fairly accurate idea of the amount of 'whole' rupees imported into the area during the cotton season. The statistics of notes imported by private agencies, which were compiled from the reports of agents of the Bank and Treasury Officers, were necessarily only rough estimates. The Table 2 gives figures for the span of years in which the reports are available. These figures indicate the important part played by the I.B.I., and Government treasuries in providing the money required for payments to the cultivator for the crop.

1. The branch in Dhulia opened only after the end of the 1921-22 season.

2. Incorporated into the I.B.I., now in S.B.I. Archives.
<table>
<thead>
<tr>
<th></th>
<th>1921-22</th>
<th>1922-23</th>
<th>1923-24</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Area I</td>
<td>Area II</td>
<td></td>
</tr>
<tr>
<td>I. Value of drafts purchased at Branches of I.B.I.</td>
<td>85669</td>
<td>93462</td>
<td>150030</td>
</tr>
<tr>
<td>II. Telegraphic transfers paid by I.B.I. Branches</td>
<td>7933</td>
<td>11759</td>
<td>20854</td>
</tr>
<tr>
<td>III. T.T. and supply bills issued in Bombay and paid at Government Treasuries and Sub-Treasuries</td>
<td>18619</td>
<td>20338</td>
<td>27023</td>
</tr>
<tr>
<td>IV. Whole Rupees taken from Bombay and railed to Area</td>
<td>33524</td>
<td>17756</td>
<td>20955</td>
</tr>
<tr>
<td>V. Notes privately imported</td>
<td>34000</td>
<td>23500</td>
<td>43162</td>
</tr>
<tr>
<td>VI. Grand Total</td>
<td>179745</td>
<td>166815</td>
<td>262024</td>
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</table>
TABLE TWO (contd...)

COTTON GROSS ABSORPTION

<table>
<thead>
<tr>
<th></th>
<th>1924-25</th>
<th></th>
<th>1925-26</th>
<th></th>
<th>1926-27</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Area I</td>
<td>Area II</td>
<td>Area I</td>
<td>Area II</td>
<td>Area I</td>
</tr>
<tr>
<td>I.</td>
<td>97917</td>
<td>36247</td>
<td>81661</td>
<td>34029</td>
<td>66758</td>
</tr>
<tr>
<td>II.</td>
<td>6288</td>
<td>1794</td>
<td>4100</td>
<td>1360</td>
<td>5017</td>
</tr>
<tr>
<td>III.</td>
<td>25052</td>
<td>655</td>
<td>16112</td>
<td>725</td>
<td>15768</td>
</tr>
<tr>
<td>IV.</td>
<td>3561</td>
<td>9077</td>
<td>6034</td>
<td>6256</td>
<td>42</td>
</tr>
<tr>
<td>V.</td>
<td>24625</td>
<td>6185</td>
<td>7879</td>
<td>4735</td>
<td>8178</td>
</tr>
<tr>
<td>VI.</td>
<td>157441</td>
<td>53958</td>
<td>109974</td>
<td>46883</td>
<td>95763</td>
</tr>
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</table>

...contd./-
TABLE TWO (contd...)

COTTON GROSS ABSORPTION

<table>
<thead>
<tr>
<th></th>
<th>1927-28</th>
<th>1928-29</th>
<th>1929-30</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Area I</td>
<td>Area II</td>
<td>Area I</td>
</tr>
<tr>
<td>I</td>
<td>107123</td>
<td>39330</td>
<td>116066</td>
</tr>
<tr>
<td>II</td>
<td>6099</td>
<td>2446</td>
<td>4829</td>
</tr>
<tr>
<td>III</td>
<td>21033</td>
<td>1549</td>
<td>19028</td>
</tr>
<tr>
<td>IV</td>
<td>24</td>
<td>8560</td>
<td>33</td>
</tr>
<tr>
<td>V</td>
<td>10342</td>
<td>6520</td>
<td>11289</td>
</tr>
<tr>
<td>VI</td>
<td>144621</td>
<td>58405</td>
<td>157245</td>
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...contd./-
TABLE TWO (contd...)

COTTON GROSS ABSORPTION

<table>
<thead>
<tr>
<th></th>
<th>1930-31</th>
<th>1931-32</th>
<th>1932-33</th>
<th>1933-34</th>
</tr>
</thead>
<tbody>
<tr>
<td>Area I</td>
<td>44498</td>
<td>224381</td>
<td>18070</td>
<td>9741</td>
</tr>
<tr>
<td>Area II</td>
<td></td>
<td></td>
<td>35455</td>
<td>7783</td>
</tr>
<tr>
<td>II.</td>
<td>6613</td>
<td>2373</td>
<td>5525</td>
<td>1800</td>
</tr>
<tr>
<td>III.</td>
<td>10396</td>
<td>695</td>
<td>5520</td>
<td>1800</td>
</tr>
<tr>
<td>IV.</td>
<td>-</td>
<td>252</td>
<td>78</td>
<td>1552</td>
</tr>
<tr>
<td>V.</td>
<td>5959</td>
<td>6455</td>
<td>952</td>
<td>2950</td>
</tr>
<tr>
<td>VI.</td>
<td>67466</td>
<td>32263</td>
<td>38345</td>
<td>17619</td>
</tr>
</tbody>
</table>
They, however, do not give an accurate idea of the amount of actual currency transferred to the area in question during the cotton season.\(^1\) This was because during the last two or three months of the season, the currency which came back to the branches of the Imperial Bank and treasuries in payment of Government dues, was re-used to meet the demand for payment of crops brought into the up-country markets.

An examination of the monthly figures of absorption from currency chests shows that currency was usually absorbed continuously until about 3/4th of the crop was marketed,\(^2\) after which a return from circulation set in. However, this could vary depending on the magnitude of crop actually harvested, stocks held, and the actual price of the crop on the international markets. In 1921-22, the absorption of currency started in October, and reached a maximum by the end of January, while in 1922-23, the season began much later in November, and did not reach a maximum till February. Table 3 below shows the total busy season duration throughout the year. Although these figures do not apply to the cotton season in particular,

\(^{1}\) These were figures for gross inputs of currency and demand drafts to the area under consideration.

\(^{2}\) See, Provincial Banking Enquiry Report for Central Provinces and Berar; Chapter 'Marketing', Para reference 1119-1124-1. This is only for cotton.
<table>
<thead>
<tr>
<th>Period</th>
<th>Busy season absorption</th>
<th></th>
<th>Slack season return</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Notes</td>
<td>Coins</td>
<td>Total</td>
</tr>
<tr>
<td>1 Feb., 1920 to 31 Aug., 1920</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Sep., 1920 to 31 Mar., 1921</td>
<td>2015</td>
<td>-1026</td>
<td>989</td>
</tr>
<tr>
<td>1 Apr., 1921 to 31 Jul., 1921</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Aug., 1921 to 31 Dec., 1921</td>
<td>1819</td>
<td>71</td>
<td>1890</td>
</tr>
<tr>
<td>1 Jan., 1922 to 31 Aug., 1922</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Sep., 1922 to 31 Dec., 1922</td>
<td>2215</td>
<td>124</td>
<td>2339</td>
</tr>
<tr>
<td>1 Jan., 1923 to 31 Aug., 1923</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Sep., 1923 to 29 Feb., 1924</td>
<td>3215</td>
<td>1437</td>
<td>4702</td>
</tr>
<tr>
<td>1 Mar., 1924 to 31 Jul., 1924</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Aug., 1924 to 28 Feb., 1925</td>
<td>2137</td>
<td>641</td>
<td>2778</td>
</tr>
<tr>
<td>1 Mar., 1925 to 31 Jul., 1925</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Aug., 1925 to 31 Dec., 1925</td>
<td>3913</td>
<td>141</td>
<td>4054</td>
</tr>
</tbody>
</table>

...contd./
### TABLE THREE (contd.)

CURRENCY REPORTS OF STERLING 1935-36/1936-37

(lakhs of rupees)

<table>
<thead>
<tr>
<th>Period</th>
<th>Busy Season absorption</th>
<th>Slack season return</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Notes</td>
<td>Coins</td>
</tr>
<tr>
<td>1 Jan., 1926 to 31 Aug., 1926</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Sep., 1926 to 28 Feb., 1927</td>
<td>2405</td>
<td>-324</td>
</tr>
<tr>
<td>1 Mar., 1927 to 31 Jul., 1927</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Sep., 1927 to 31 Dec., 1927</td>
<td>2829</td>
<td>197</td>
</tr>
<tr>
<td>1 Jan., 1928 to 31 Aug., 1928</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Sep., 1928 to 31 Dec., 1928</td>
<td>2413</td>
<td>413</td>
</tr>
<tr>
<td>1 Jan., 1929 to 30 Sep., 1929</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Oct., 1929 to 31 Dec., 1929</td>
<td>1277</td>
<td>195</td>
</tr>
<tr>
<td>1 Jan., 1930 to 31 Jul., 1930</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Aug., 1930 to 31 Dec., 1930</td>
<td>707</td>
<td>-638</td>
</tr>
<tr>
<td>1 Jan., 1931 to 31 Aug., 1931</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Sep., 1931 to 29 Feb., 1932</td>
<td>3469</td>
<td>1572</td>
</tr>
</tbody>
</table>

...contd./-
TABLE THREE (contd...)
CURRENCY REPORTS OF STERLING 1935-36/1936-37
(lakhs of rupees)

<table>
<thead>
<tr>
<th>Period</th>
<th>Busy season absorption</th>
<th>Slack season return</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Notes</td>
<td>Coins</td>
</tr>
<tr>
<td>1 Mar., 1932 to 31 Jul., 1932</td>
<td>2482</td>
<td>419</td>
</tr>
<tr>
<td>1 Aug., 1932 to 31 Dec., 1932</td>
<td>1227</td>
<td>-37</td>
</tr>
<tr>
<td>1 Jan., 1933 to 31 Aug., 1933</td>
<td>688</td>
<td>482</td>
</tr>
<tr>
<td>1 Sep., 1933 to 28 Feb., 1934</td>
<td>1418</td>
<td>247</td>
</tr>
<tr>
<td>1 Mar., 1934 to 31 Aug., 1934</td>
<td>877</td>
<td>458</td>
</tr>
<tr>
<td>1 Sep., 1934 to 28 Feb., 1935</td>
<td>1137</td>
<td>167</td>
</tr>
<tr>
<td>1 Mar., 1935 to 30 Aug., 1935</td>
<td>1506</td>
<td>719</td>
</tr>
<tr>
<td>31 Aug., 1935 to 10 Apr., 1936</td>
<td>1875</td>
<td>-224</td>
</tr>
<tr>
<td>11 Apr., 1936 to 31 Jul., 1936</td>
<td>1260</td>
<td>731</td>
</tr>
<tr>
<td>1 Aug., 1936 to 12 Feb., 1937</td>
<td>3682</td>
<td>449</td>
</tr>
<tr>
<td><strong>TOTAL:</strong></td>
<td>37753</td>
<td>3455</td>
</tr>
<tr>
<td></td>
<td>34506</td>
<td>16627</td>
</tr>
</tbody>
</table>
these illustrate the variation that normally took place, generated by not only weather conditions, but also by marketable surpluses, prices and so on.

Table 4 shows, for the years 1921-22 to 1933-34, the net absorption of currency in the cotton areas between the time when demand for money started, and when it reached its maximum. Statistical information on the movement of jute and rice is meagre. Table 5 presents what is available.

These detailed tables, perhaps the only statistical material available on the amounts of currency involved in busy season crop movement, give a picture of what part the Imperial Bank played in the expansion of currency.

Gross and net absorption represents credit notes posted between head office and branch office, and not actual physical quantities of currency involved in the transfer between hinterland and port. Gross absorption as a percentage of the total value of the crop (Table 1) would exaggerate the part played by the Imperial Bank as it would take into account, paper used only for accounting purposes. Net absorption as a percentage of the total value of the crop would represent a more realistic picture of Imperial Bank's participation in crop movement, in this case, the movement of cotton from Central India to the port of Bombay. With such figures in hand, it is possible to guage busy season expansion and the influence of organised credit on the movement of cotton staple, for export and internal consumption.
Judging by the figures on Net Absorption given below the I.B.I. financed the movement of crop to the extent of 35.53% for Cotton and 44.21% for Jute. Given however the rough and ready nature of these figures an analysis of annual trend would not really be statistically be justified. All that can be said is that based on an average of the twelve or thirteen years for which figures are available the I.B.I. was crucial to the finance of seasonal crop movement. No other Bank participated so enormously or to such an extent; thus monetary policy conducted through the I.B.I. could vary agrarian purchasing power very substantially. 1

1. See chart on 'Net Absorption as a Percentage of the Total Value of the Cotton and Jute Crop, 1921-22 to 1933-34. The Busy and Slack Season statistical exercise is continued in Appendix III where the Seasonal Cycle is illustrated in detail.
TABLE FOUR
COTTON NET ABSORPTION
( 000's )

<table>
<thead>
<tr>
<th></th>
<th>1921-22</th>
<th></th>
<th>1922-23</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes</td>
<td>Rupees</td>
<td>Notes</td>
<td>Rupees</td>
<td></td>
</tr>
<tr>
<td>I. Absorption of currency from currency chests</td>
<td>66628</td>
<td>13321</td>
<td>81665</td>
<td>22680</td>
</tr>
<tr>
<td>II. Whole rupees from Bombay Currency Office</td>
<td>-</td>
<td>33524</td>
<td>-</td>
<td>17756</td>
</tr>
<tr>
<td>III. Notes imported by private agencies</td>
<td>34000</td>
<td>-</td>
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<td>46845</td>
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<td>40436</td>
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...contd./-
TABLE FOUR (contd...)
COTTON NET ABSORPTION

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<td>Notes</td>
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<td>IV.</td>
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...contd./-
### TABLE FOUR

COTTON NET ABSORPTION (contd...)

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<td>Notes</td>
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...contd./-
TABLE FOUR

COTTON NET ABSORPTION (contd...)

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<td>Notes</td>
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<tbody>
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<td>Rupees</td>
<td>Notes</td>
<td>Rupees</td>
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<td>III.</td>
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contd.../-
## TABLE FOUR

**COTTON NET ABSORPTION (contd...)**

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<td>Notes</td>
<td>Rupees</td>
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<td>9577</td>
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<td>2292</td>
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<td>14868</td>
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<td>2317</td>
<td>14685</td>
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<td>7557</td>
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<td>17002</td>
<td>36500</td>
<td>12135</td>
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<td></td>
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...contd./-
### TABLE FOUR
COTTON NET ABSORPTION (contd...)

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<tr>
<td>I.</td>
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<tr>
<td>III.</td>
<td>11985</td>
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<td>26224</td>
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IV. 48493
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</tr>
</thead>
<tbody>
<tr>
<td>Bengal, Bihar, Orissa, Assam (000)</td>
<td>26811</td>
<td>34705</td>
<td>39827</td>
<td>388456</td>
<td>52630</td>
<td>51149</td>
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<tr>
<td>Rs./Maund</td>
<td>12.0.0</td>
<td>7.5.0</td>
<td>13.1.0</td>
<td>18.11.0</td>
<td>10.1.0</td>
<td>10.5.6</td>
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<td>Total value of crop (crores)</td>
<td>32.17</td>
<td>25.37</td>
<td>52.02</td>
<td>72.59</td>
<td>52.95</td>
<td>52.90</td>
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...contd./-
### TABLE FIVE

**JUTE (contd...)**

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<th>Year</th>
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<th>1929-30</th>
<th>1930-31</th>
<th>1931-32</th>
<th>1932-33</th>
<th>1933-34</th>
</tr>
</thead>
<tbody>
<tr>
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<td>48836</td>
<td>54595</td>
<td>27027</td>
<td>28411</td>
<td>38564</td>
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<tr>
<td>Rs./Maund</td>
<td>-</td>
<td>9.13.0</td>
<td>5.8.0</td>
<td>5.4.0</td>
<td>4.4.0</td>
<td>4.0.0</td>
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<tr>
<td>Total value of crop (crores)</td>
<td>54.53</td>
<td>47.92</td>
<td>30.02</td>
<td>14.18</td>
<td>12.07</td>
<td>15.42</td>
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...contd./-
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<th>TABLE FIVE</th>
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<tbody>
<tr>
<td>JUTE</td>
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</tbody>
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<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>I. Value of drafts purchased at I.B.I. Branches</td>
<td>89481</td>
<td>80423</td>
<td>135836</td>
<td>207395</td>
<td>145288</td>
<td>159700</td>
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<tr>
<td>II. Telegraphic transfers paid</td>
<td>17676</td>
<td>21532</td>
<td>23701</td>
<td>31377</td>
<td>15241</td>
<td>21261</td>
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<td>III. T.T. and supply bills issued in Calcutta at treasuries and sub-treasuries</td>
<td>22742</td>
<td>26157</td>
<td>36484</td>
<td>55451</td>
<td>40695</td>
<td>38778</td>
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<td>IV. Whole rupees railed into the area</td>
<td>376</td>
<td>196</td>
<td>-</td>
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<td>V. Notes and coins imported by private agency</td>
<td>40440</td>
<td>41569</td>
<td>63037</td>
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<td>-</td>
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<tr>
<td>VI. Absorption of currency from C.C's</td>
<td>-</td>
<td>-</td>
<td>160755</td>
<td>-</td>
<td>149194</td>
<td>-</td>
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<tr>
<td>VII. TOTAL</td>
<td>170715</td>
<td>169877</td>
<td>419817</td>
<td>294223</td>
<td>201224</td>
<td>199739</td>
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<td></td>
<td></td>
<td>38%</td>
<td>37.7%</td>
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...contd./-
### TABLE FIVE

**JUTE (contd...)**

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<th>1929-30</th>
<th>1930-31</th>
<th>1931-32</th>
<th>1932-33</th>
<th>1933-34</th>
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<tbody>
<tr>
<td>I. Value of drafts purchased at I.B.I. Branches</td>
<td>161648</td>
<td>95178</td>
<td>67960</td>
<td>42158</td>
<td>30178</td>
<td>25696</td>
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<tr>
<td>II. Telegraphic transfers paid</td>
<td>22061</td>
<td>14332</td>
<td>7035</td>
<td>5066</td>
<td>9697</td>
<td>10010</td>
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<tr>
<td>III. T.T. and supply bills issued in Calcutta at treasuries and sub-treasuries</td>
<td>43584</td>
<td>36431</td>
<td>19152</td>
<td>11309</td>
<td>11171</td>
<td>8804</td>
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<tr>
<td>IV. Whole rupees railed into the area</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>V. Notes and coins imported by private agencies</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>VI. Absorption of currency from C.C's</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>VII. TOTAL</td>
<td>227293</td>
<td>145941</td>
<td>87147</td>
<td>58533</td>
<td>51040</td>
<td>44510</td>
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<tr>
<td></td>
<td>41.7%</td>
<td>30.5%</td>
<td>29.02%</td>
<td>41.2%</td>
<td>42.3%</td>
<td>28.9%</td>
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</table>
### Net Absorption as a Percentage of the Total Value of Cotton and Jute Crop 1921-22 to 1933-34

<table>
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<tr>
<th>Year</th>
<th>Net Absorption</th>
<th>Total Value</th>
<th>Cotton %</th>
<th>Jute %</th>
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<tbody>
<tr>
<td>1921-22</td>
<td>147473</td>
<td>474600</td>
<td>31.07</td>
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<td>1922-23</td>
<td>145601</td>
<td>498400</td>
<td>29.21</td>
<td>53.06</td>
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<td>1923-24</td>
<td>310877</td>
<td>611700</td>
<td>50.82</td>
<td>66.95</td>
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<td>1924-25</td>
<td>175051</td>
<td>457400</td>
<td>38.27</td>
<td>80.70</td>
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<td>1925-26</td>
<td>118486</td>
<td>348900</td>
<td>33.95</td>
<td>40.53</td>
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<td>1926-27</td>
<td>106229</td>
<td>285600</td>
<td>37.19</td>
<td>38.00</td>
</tr>
<tr>
<td>1927-28</td>
<td>154839</td>
<td>395200</td>
<td>39.17</td>
<td>37.70</td>
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<td>161644</td>
<td>379200</td>
<td>42.62</td>
<td>41.70</td>
</tr>
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<td>1929-30</td>
<td>94319</td>
<td>331500</td>
<td>28.45</td>
<td>30.50</td>
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<td>1930-31</td>
<td>59035</td>
<td>189800</td>
<td>31.10</td>
<td>29.02</td>
</tr>
<tr>
<td>1931-32</td>
<td>43902</td>
<td>105500</td>
<td>41.61</td>
<td>41.20</td>
</tr>
<tr>
<td>1932-33</td>
<td>45635</td>
<td>153700</td>
<td>29.69</td>
<td>42.30</td>
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<td>1933-34</td>
<td>48493</td>
<td>168000</td>
<td>28.86</td>
<td>28.90</td>
</tr>
</tbody>
</table>

Average Percentage: 35.53  44.21

Source: Report of the Controller of Currency. for the relevant years.
The Seasonal Oscillation

The finance of jute, rice and other major crops in the country would, we presume, conform to a pattern that was roughly similar. Enormous funds disgorging themselves from the major urban trade centres to be transferred up-country for crop movement, generated a seasonal oscillation in money.

Every year, as seasonal requirements of finance were felt in the money markets of Calcutta and Bombay, interest rates would jump, liquidity preference would increase, velocity of circulation would be more rapid; the entire economy was subjected to boom conditions reminiscent of the top end of a trade cycle with relatively intense commercial activity.1

By late December/early January, the Bank rate would jump to 7 per cent - sometimes 8 per cent -, as huge funds disgorged themselves for the seasonal finance of crops in the form of Bills of Exchange.2

1. See, Charts and indexes attached on the seasonal infuctuation of various classes of Bank Funds and other economic indications such as interest etc. from 'Banking and Monetary Statistics', and R.B.I. publication.

2. See, B.M.S./R.B.I., Section 8 Table 4, 'Bank Rate - Imperial Bank of India, January 1921 - December 1952', pp.693-94. See Appendix III.
It was during the busy season that the cash position of the Imperial Bank, and equally of every other bank, involved in the export trade, would fall to the panic levels.\(^1\) Bills discounted, indicating trade demand for finance, would multiply rising in inverse proportion to 'cash at hand' in the Imperial Bank. Equally, the busy season expansion, would agitate call money rates, cash credits, over-drafts, bazaar bill rates, absorption and return of the rupee coin. Hundri rates, Government deposits, and ways and means expenditure, imposed a very strong seasonal pattern, that was remarkable in its periodicity.

The Monetary Consequences

In a primarily agricultural economy like that of India, dominated by a seasonal oscillation, the movement of agricultural staple, absorbed a much larger

\(^1\) B.M.S./R.B.I., Section 2 Table 2, 'Imperial Bank of India - Liability and Assets - Weekly and Monthly 1921-1952', p.32; cash in hand, at banks.

Table 'Indian Schedule Banks Business in India, Weekly and Monthly, July 1935-December 1952' - Cash in hand.

Table 5 'Exchange Banks - Business in India Weekly and Monthly, July 1935-December 1952', Cash in hand. See Appendix III.
proportion of investible surplus than all other forms of industrial investment put together.¹

1. Monetary variables i.e., money stock prices, interest rates, velocity of circulation, fluctuated seasonally and were determined by a clearly demarcated busy and slack season in the production and harvest of agricultural commodities. The seasonal oscillation was so marked that the demand and supply of money agitated all forms of productive activity and imposed a strong annual rhythm on the economy.

This was in marked contrast to a metropolitan economy. The latter, composed of an industrial structure capable of multiplying and absorbing capital investment, was subject to a trade cycle. The oscillations in the level of commercial and industrial activity in such an economy therefore assumed an entirely different character. Industrial production first grew accelerated by low rates of interest and easy credit outran its own markets, and then collapsed upon itself in a fever of speculation, high liquidity and ultimately a sharp fall in business activity.

Trade cycles in an industrial economy have been explained in terms of business investment, and its effect through the multiplier process on the level of national income. The accelerator theory of investment in conjunction with the multiplier has been used to show that the adjustment of the level of investment to the rate of change of sales, gives rise to cyclical fluctuations in national income. In a seasonal economy the reason why the acceleration principle did not function was because capital inputs did not enter the process of production in the same magnitude that it entered the sphere of the circulation and distribution of commodities. Admittedly, investment did flow into production, especially the export enterprises as well as into indigenous manufacture as in cotton textiles. Nevertheless there is a good body of evidence to suggest that in terms of absolute magnitudes, seasonal agricultural exports absorbed a much larger proportion of investible surplus than all other forms of industrial investment put together.

As a result, there was a rate or weak accelerator or multiplier principle at work. National income, by and large, remained stable without a general increase in productive capacity in agriculture.

This dominance of commercial capital in agriculture may arguably be regarded as responsible for the very low levels of productivity and the general absence of capitalist enterprise in agriculture. Colonial administrative policy deliberately handicapped industrial enterprise, and promoted overhead investment that

...contd./-
Thus we find that, in the inter-war economy, trade continued to absorb enormous sums of both short-term investment and investment directed into the development of overheads related to crop movement. Very little was invested in the process of agricultural production, or in techniques that would have multiplied agricultural productivity. Though indigenous industry grew during the inter-war period, and the hold of the metropolitan economy weakened, the basic structure of colonial production of agricultural staple remained unmodified. The structure of the agrarian economy and the circulation of money maintained the total overall influence, that the seasonal movement of export staples had on the bank rate, interest rates, prices, velocity of circulation, money stock and transactions.

Trade and the Bank Rate 1933 Onwards

There was an exception to this rule. In 1933-34, after the steep rise in interest rates, the bank rate dropped precipitously to 3.5 per cent, and settled at this figure for the rest of the year. This was the first time since the beginning of organised banking that no

(footnote contd...)
change in the bank rate was made during the whole of the financial year. (In the subsequent year 1934-35, the rate dropped from 3.5 percent to 3 percent and there were only minor alterations in the rate until 1939, when the Second World War boom agitated the economy.

The absence of any seasonal fluctuation in the rate was an indication of the extreme slackness of trade demand and the very low levels of commodity prices. The large exports of gold had fallen off and the enormous expansions of currency were no longer necessary. Without the large annual inflow and outflow of currency, the bank rate stood unvaryingly at 3.5 and 3 percent. The call money rate still registered minor fluctuations in the demand for money. On one occasion the call money rate jumped to 4 percent (in October 1933) when the failure of a large firm of managing agents in Bombay precipitated a run on local banks, but the call rate soon settled down well below the bank rate at 1.25 per cent.
India and the World Economy

The slackness of commerce and the unchanging Bank rate would suggest a certain sympathy between the world depression and trade conditions in the Indian economy. Indeed if we take the liberty of defining India as a sub-adjunct of a global system, then it would follow that international economic disturbances were reflected by trade imbalances in India. However, the relationship was not as simple or as direct.

As an economy that was geared to the production of agricultural raw material, the only channel through which trade disturbances were transmitted to the Indian economy, was the price of exported primary produce. A collapse of the world market would have decreased the demand for India's traditional exports that would as a consequence have fallen in price. Nevertheless, this would not have exerted a general pressure on the whole-sale price index, nor could it have led to a widespread dislocation of agricultural production. 1

1. The shock to the seasonal economy was massive enough to interrupt its annual trade cycle and disturb the internal flow of capital. Had the Indian depression been a simple reflection of the metropolitan trade cycle, the rise in the price of exported commodities should have been a sufficient catalyst to revive internal trade. However, the economic havoc of the Depression and post-Depression years was extensive, and it was not till 1940 that trade demand reinforced the seasonal ebb and flow of agricultural finance.
It was the influence of the over-valued rupee, linked to sterling that accelerated the influence of the world-wide fall in commodity prices.¹ The management of currency was forced to ensure the rupee-sterling ratio, a priority that exerted a far more important downward pressure on internal prices, than the disruption of India's export trade.

The high exchange policy inhibited internal trade and depressed the income of the agriculturist at a time when the purchasing power of the urban salaried class actually increased. As a result, deposits in banks and urban construction expanded. Industry, especially textiles, benefited from the drop in imports, but the

¹. This is a radical departure from the usual description of falling prices. S.N. Sen Gupta who wrote in 1939 believed that it was through export prices that the general drop in the level of prices was enforced.

"India's exports to these countries were seriously affected (European countries damaged by the Wall Street crash) and hence the whole-sale prices of her chief products were seriously reduced. At the same time, the prices of those commodities of which India is not a chief producer, fell along with world prices. Prices of competing commodities also naturally fell in sympathy. In course of time the retail prices and the harvest prices were also affected to an equal extent."

By an all-round fall in purchasing power generated by a fall in the price of exported commodities Sen Gupta feels that a vicious circle was perpetuated and all prices were pushed down in closer sympathy.

advantage was selective. Despite this, the overall statistics of production expanded. Clearly, such a scenario was not a repeat of the Western trade cycle, nor can it be associated with the more traumatic dislocation that the industrial economies were subjected to.

**Monetary Character of the Seasonal Economy**

Throughout the inter-war period, though monetary management became an important part of Imperial policy, the monetary character of the colonial economy remained a scarcely understood phenomenon. The seasonal absorption of money, the cultivator's preference for gold, the heightened speculation, all these features often baffled administrative officials who explained them away as nuances of a backward peasant mentality. Even the voluminous proceedings of the currency committee's and the Banking Enquiry Report did not go beyond a description of the monetary process, and were unable to reach an analytical definition of the seasonal economy. At best, currency officials and the Finance Department could react to a monetary crisis by expanding or contracting currency; they could neither anticipate a contingency, nor did they have enough control to regulate a serious absorption or release of currency, once such a movement had been set in
motion. Additionally, despite the growing sophistication of monetary management during the inter-war period, currency control could only decrease or increase money stock in the limited proximity of the urban trade centre. Organised credit had little influence over the circulation of money beyond the trade centre into the hinterland, where credit was entirely controlled by a predatory set of money-lenders.

As such, the dis-association between organised and indigenous credit, could perhaps be a step towards the definition of a monetary duality in the inter-war economy. Among the most prominent symptoms of this monetary duality was the irrational preference for bullion which generated an enormous demand for both gold and silver. This

1. The Fin. Dept. was not unaware of the limits of organised banking. Straight-forward contraction was possible, but its consequences could be very different from similar measures on the London money market.

"I doubt, for instance, whether they (India Office) have realised the great difference between Indian and Home conditions owing to the imperfectly developed banking system here. To my mind the important fact in considering deflation is that most of our note issue is unfortunately in the hands of the public and not in the banks. Thus, in the second week of January, out of a total circulation of 172 crores only 12½ crores were in the I.B.I., and I expect very little more in outside banks. It follows, therefore, that the full weight of any deflation must fall on the comparatively small fraction of the total circulation which is accessible, i.e. which is with the Imperial Bank.

insatiable appetite for bullion in an economy that had been familiar with fiduciary currency was an uncomfortable paradox for those in-charge of currency.

Equally difficult were imperfections within the structure of organised credit, that could thwart a contraction or expansion of currency, by absorbing or re-supplying a temporary monetary disequilibrium. The only really insurmountable obstacle to money balance was, that if exchange remained persistently above or below gold point, an inflationary or a deflationary sequence could only be enforced by massive changes in money stock. If such changes, especially an expansion of currency, were not accompanied by an equally enormous input of silver, fiduciary currency alone would have been unacceptable and as a result redundant. It was the primitive dependence on bullion and silver coin which described the more draconic efforts at preserving exchange equilibrium.

The first three sections of Part III on Bullion, the exchange rate, and on the extended influence of metallic currency, are an examination of these fractures and their overall command over money supply.

The section on long and short rates explores the peculiar relationship that governed interest rates in an economy that generated an enormous demand for
short-term finance. The viability of commercialised agriculture, and an internal market biased in favour of imported manufacture was so strong that it was only in times of a depression in the metropolitan economy, or on an actual break in trade that indigenous industry grew. Interest rates had only a marginal effect on industrial investment, in an economy specialised in the export of primary produce, which would suggest that any incidental monetary advantage in promoting industrial growth was weak and unsatisfactory.

Thus, even in strictly monetary terms the retarded agrarian economy dominated by the commercialisation of agriculture and a bias towards the export of primary produce was a deeply imbedded pattern, and an enormous influence on all productive activity in the colonial economy.

**Bullion Hoards and Money Circulation**

The demand for bullion was a feature of such a pattern and one that had an enormous influence on money supply.¹ What was remarkable was that in an economy that

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¹ The structure of monetary preferences was most strikingly displayed by the use and function of bullion in colonial economy. The utility of gold and silver cannot in any sense be compared to the use of bullions in a petty-commodity economy. It must be kept in mind that we are not dealing with an incipient capitalist economy, but an agricultural economy that had been specifically modified as a colonial adjunct of a metropolitan economy.

had been structured by modern institutional arrangements to aid the circulation of money, there existed a parallel circulation of metallic money that accounted for the huge quantities of precious metal attached to hoards.

It has been observed that in the absence of any imports of gold in a particular year the return of currency (both note and coin) from up-country was exceedingly slow. Conversely, a smaller absorption of currency was normal in years when large transfers and the sale of bullion took place at the same up-country markets.¹ There existed a relationship between the absorption of gold and the return

(Footnote contd...)

¹Vini accounts for the monetary preference for gold in
(a) countries where the banking habit is not widespread, there is a tendency for currency to preponderate in money supply, (b) economies where the average size of transaction is invariably small, there is a correspondingly greater use of coins and subsidiary currency (gold, bullion, silver etc.).

¹. For normal transaction requirements, separate entirely from the requirements of bullion for hoarding, gold was preferred because it had a greater monetary utility than silver. If the relative price of the two metals remained at a rough parity, then there would be a tendency for the preference in favour of gold to steadily increase the quantity in circulation, and not in hoards. The Chamberlain Committee observed:

"A very considerable portion of the gold absorbed in the Punjab was actually in circulation as currency, that in some cases better rates and terms could be obtained when gold was tendered in payment of produce than when silver was offered."

of currency to the urban trade centre that was determined by the function of metallic money in a primitive economy. Such an economy fractured by an incompletely developed internal market, suffered from uneven commercial activity especially because transport and facilities of communication were not constructed to catalyse inter-regional trade.

Bullion acted as a medium between regional currencies especially in areas where the harvest and movement of a commercial crop involved more than one currency.¹

The Oomra cotton crop which was grown in Baṣi Nagar in Central India, spanned an area where both British Indian currency and Hyderabad State currency

1. The existence of regional currencies complicated trade operations that spanned more than one currency area. Payments outside the State had to be effected in another coinage involving the medium of a money changer who would charge a discount that would vary with commercial conditions in the area. J.C. Nixon wrote:

The people who deal in money changing and in hundis, do so for profit and in consequence whatever exchange is in demand, either from Government coinage into State coinage, or from State coinage into Government coinage, a certain profit remains in the hands of the money changer."

This restricted trade and tended to raise the price of commodities, which strengthened very effectively the bias towards gold as a form of universal currency.

Note by J.C. Nixon (Under Secy. Fin. Dept.) to the Committee of Princes appointed to consider the advantages and disadvantages of the adoption of a universal currency. Acc. & Fin. - Feb. - 238, Part C/1921, N.A.I.
were accepted in commercial transactions. Here gold was used as a 'national money', and overcame the local character of regional currency since each currency came to be valued in terms of silver and gold.¹

The inflow and outflow of precious metals from one regional sphere of circulation to another, inasmuch as this was caused by the unacceptability of one national fiduciary currency encouraged the hoarding of precious metal. Banking facilities in areas even where commercial crop was grown were not always distributed well enough to guarantee convertibility or even a return in terms of interest on accumulated capital.² In the absence of such facilities in areas where commercial activity and the circulation of commodities could be rapid, a polarity in the use of fiduciary currency developed. Once the cultivator gained his normal profits from the sale of his crop he undertook all bazaar transactions for items he consumed in notes. Having completed the purchase of his

1. Indian Provincial Banking Enquiry Report for the Central Provinces and Berar 1929.

2. See, Hilton-Young Commission, op.cit. 1926. The decrease of hoarding by means of an agricultural credit system, App. p.604, Gustaf Cassell. Increased Banking facilities and development of investment, Banerjea 6825 (Para ref.); Sinha 7465-6, Kish 10873.
requirements with notes, the balance of his earnings he stored in coins.¹ If the price of bullion was favourable, the cultivator then partly or wholly replaced his hoard of coins with precious metal.²

A distinction thus developed between money, i.e. notes as a means of purchase and payment (notes); and money, i.e. coins as a store of value (coin or bullion). During the cold season of 1927 after the cotton crop had been harvested, the proportion of silver and coin that had been absorbed in Barsi Nagar convinced local officials that the cultivator's taste for coins had not dimmed. A comparison

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1. Various estimates of the amount of Indian hoards have been put forward from time to time. Macleod was the first economist who started the theory of hoards and estimated the amount at £300 m. Arnold Wright compared their value at £200 m. On what data these estimates were based, is not known. Although, there is no statistical data for ascertaining the magnitude of hoards. Joseph Kitchen estimated that India's absorption of gold was about £553 m or 15 per cent of a world estimated total gold output of £4000 in 1924. Silver absorption, Sir James Wilson, estimated that between 1835 and 1919 India imported one-third of the world production or 2,900 million ounces.

Memorandum on hoarding P.T.Pvt. Paper, File No.504.

2. British administrators were aware of the fact that the cultivator stored coins as a savings to be used when needed.

Hilton-Young Commission 1926, Evidence Basil Blackett (for the year 1924-25), Blackett Para ref. 434-35.

See also, B.F. Medon, Para ref. 3578.
with five years before that date seemed to show that
the cultivator, after he had met his immediate
requirements, such as land revenue, still preferred to
retain his surplus in coin.¹ A prosperous season would
have thus led to not only an increase in the proportion
of currency absorbed, but also in the greater percentage
of coin to notes.

There is little doubt that the mere extension of
money transactions and the commercialisation of the
colonial economy assured the acceptability of fiduciary
currency in the circulation of commodities. But in an
economy where commercial capital dominated agricultural
operations associated with it, production outlets for
accumulated capital were available to the trader-
middleman, money-lender and not to the cultivator. Thus,
in the absence of both facilities of banking² and

¹. A local enquiry was instituted towards the close of
the year 1926-27 under the direction of J.B. Taylor,
Offg. Controller, to ascertain from Deputy Controllers
of Currency and district officers throughout India
the reasons for the large returns of rupees, which was
unprecedented except in 1920-21.

See, the Report volumes themselves, the results of
the report are printed along with the normal subject
matter of the report.

². Various Committees, especially the Babington Smith
Committee, were not unaware of the lack of facilities
for banking and its intimate connection with the
amount of gold absorbed.

"We do not therefore consider that the quality of gold
taken by India for all purposes... was disproportionately
large in relation to her economic conditions... until
banking and investment facilities have been extended and
the habit of using them has been acquired by the people
of India, is it easy to see in what other form savings
can be accumulated."

Report Volume Para 73 of the Majority Report of the
Babington Smith Committee quoted in Memo on hoarding,
File No.504, P.T. Pvt. papers.
independent opportunities of profitable investment in agricultural operations, the cultivator accumulated his savings in hoards of metallic value less liable to fluctuation than notes whose value was determined by Government fiat.¹ Thus although the exchange and distribution of commodities was facilitated immensely by fiduciary notes, especially after the First World War, precious metals continued to perform their role as hoards of value.²

However, there is an important body of evidence that apparently suggests the opposite conclusion.

Reports of currency officials from various parts of the country, during the inter-war period definitely pointed

1. Brij Narain 'Money and Banking', p.117.
2. There was no question of the fact that the entire fiduciary circulation depended upon its property of being ultimately convertible into metallic money. The threat of inconvertibility in 1919 was so imminent, and the consequences so frightening that the Viceroy telegraphed the S.S. to remind him that India had shared the burden of Empire in the past as it would continue to do in the future, and if India was not provided with the silver it demanded either from the British Treasury or from the United States, the Viceroy warned:

"We should respectfully submit that you are inviting us, by the alternative course which you suggest we should take to steer a straight course for economic disaster and grave political embarrassment."

to a growing popularity of currency notes. In 1920-21, the Controller of Currency's annual report went as far as to say that:

"... the figures show clearly the extent to which currency notes have supplanted rupees in the finance of not only the jute and rice crops, but also of the cotton, seeds and wheat crop on the Bombay side."

Such reports probably reflected a certain monetary equilibrium that had been temporarily restored after the war boom. The growing popularity of notes in 1920-21 was observed in contrast to the unprecedented demand for bullion that the war prosperity had generated, and did not really mark an absolute trend in the acceptance of notes rather than coin. However, similar observations on the part of currency officials were

1. In a memorandum to the Indian Currency Committee, L. Abrahams said that judging by the figures released for note and coin circulation:

"The note is apparently becoming more and more popular as large additional issues made with some misgivings during the war, have remained in circulation.... However, during the same period the demand for metallic currency has also been considerable."

He admitted that any pre-mature cessation of the issue and use of coin would be impossible to contemplate even in England, let alone in a backward country such as India.


Also Memo submitted to Fin. Dept. by C.C. M.S. Gubbay, January 23, 1918, Ibid.
repeated in 1925-26 of Punjab and in 1926-27 when a local enquiry was instituted to ascertain from the Deputy Controller of Currency and district officers throughout India the popularity of notes in relation to coin.¹

The reports emphasized that there was a growing trust in fiduciary currency coupled with an increasing familiarity with monetary custom. This was particularly noticeable in the reports of the District Officer in Burma. One of the notable features of that year was the marked decrease in the seasonal demand for coin to finance the rice crop in Burma. In 1920-21, this led a Revenue Official to report that:

"... money circulates more freely, and less disappears into buried hoards. Motor-cycles, electric torches and cinemas absorb and keep in circulation lakhs of rupees that, until two or three years ago were locked away. The enormous increase of motors and motor buses has not only kept a lot of money in circulation, but they have made new channels for trade, and luxuries are being sold in remote villages where formerly hoarding was a rule."

¹. As mentioned before, the local enquiry was instituted towards the close of the year 1926-27 to ascertain from the Deputy Controller of Currency and district officers throughout India the reasons for the large return of rupees which was unprecedented except in 1920-21. The results are published along with the Report volumes. See Report of the Controller of Currency 1926 – 27.

The report from extensive accounts from all over India referred to Sind, Hyderabad, Sukkur, where it appeared that the decrease in the use of silver rupees was almost entirely due to the increase in the popularity of notes and to the fact that banking facilities were becoming more widespread. In Karachi and Sind, bearer cheques were being accepted more freely than formerly, and in Northern India there was a falling off in the demand for whole rupees from banks and the currency office in 'Cawnpore' circle. The amount demanded and railed in 'Cawnpore', was less than half the number of silver rupees than in the previous year. In Lahore, rupees issued in batches of 10,000 or over at the counter of the currency office totalled in that year 139,000 as against 645,000 for the year before, i.e. 1925-26.

1. There is a detailed summary of the references made to hoarding, and the increasing or decreasing tendency of people to hoard metal and coin, in the Provincial Banking Enquiry Committee, compiled in File 504 Appendix A, P.T. Pvt. Papers. These references are useful in that they represent the only substantial or insubstantial work done, in ascertaining the changing habits of hoarding and the general conclusion that they reach in that the absorption of coin or metal depends on good or bad harvests and there is no marked secular trend either way.


The substitution of metallic currency did not, however, establish any visible progress towards either greater agricultural productivity or a substantial advance in rural banking, two pre-conditions for the acceptance of paper currency. Though important in itself, the popularity of paper currency in the early twenties was more apparent than real.

Indeed, even in the conclusion to the report, the Controller of Currency was hesitant to draw any such extra-ordinary generalisation. He said:

"Notes are becoming increasingly popular, especially in towns, though the progress of the substitution of paper currency for metallic coin is bound to be slow."

1. In 1930, in a private and confidential memorandum to the Fin. Dept., the Controller of Currency admitted that since 1925 there had been not sufficient evidence to suggest any material change in the currency habits of the people. Controller of Currency added that:

"Though they undoubtedly now keep a larger proportion of notes to coin than before, they would still seem to maintain roughly the same proportion of cash to their other assets."


The report admitted that despite the growing popularity of notes in the cotton and jute lands, (commercially the most advanced parts of the country) absorption of coin fluctuated with the price of agricultural staples. The Controller of Currency reported specifically, that the drop in the price of jute in 1926-27 was 'largely responsible' for the fall in the coin consumption of the Calcutta circle, where last year's consumption totalled 11 crores, the finance of crop for 1926-27 was 30 per cent less and accounted for only 8 crores of silver rupees.

Here lies the crux of the problem. It was not so much the relative consumption of notes to coin that indicated the peasant's apparent preference for fiduciary currency. It was the price of agricultural staples, and the magnitude of the net return that accrued to the cultivator which was directly proportionate to his demand for coin and bullion.¹ Since market purchases and land revenue could be serviced in paper money, coin was useful to the cultivator only as a store of value, i.e. as a saving from his gross profits.

¹ In 1925, A.C. McWatters in a private letter to Dinshaw Wacha wrote that the extraordinary increase in the absorption of gold was mainly due:

"...to the agricultural prosperity following on four good harvests, to the high price of commodities on which the agriculturist usually spends his surplus and the low price of gold."

A.C. McWatters to Dinshaw Wacha, June 19, 1925, File No.39-F/1925.
Falling Prices

If prices fell, most of what would have been his surplus went in payment of land revenue and his annual consumption needs. Since the cultivator's normal consumption transactions were undertaken in exchange for note, his demand for coin in a time of falling agricultural prices would contract as his surplus would be small or non-existent.

When in 1929-30, the fall in world commodity prices precipitated a serious drop in the prices of cotton crop, net absorption of currency dropped from 15,48,39,000 in 1927-28 to 13,96,97,000 in 1928-29 and to 9,43,19,000 in 1929-30. More important was that in the same span of three years the percentage of coin to notes in the finance of crop dropped from 78.2 per cent to 72.4 per cent to a ten year low of only 49 per cent of coin to notes.

The cultivator's preference for metallic currency had dimmed as a result of low agricultural prices and smaller profits. The absorption of currency that had commenced in October ceased earlier than expected and in


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1929-30 there was a net return of currency to trade centres owing to land revenue receipts exceeding the outgoings for the finance of cotton. The cultivator had thus been forced to liquidate his savings of metallic currency and bullion thus creating an over-supply of coins in relation to notes. In Khandesh and in districts of Central Provinces and Berar currency notes were not at their usual discount.¹

**Rising Prices**

In contrast, in times of prosperity and rising agricultural prices, large net surpluses increased the cultivator's propensity to save. Once revenue demands had been met, the large floating surplus of notes would be absorbed as savings, and the pressure to convert paper currency to metallic currency would gradually increase towards the end of the busy season. In 1922-23, in the very same areas of Khandesh and in the districts in Central Province and Berar, adjacent to the Hyderabad State, the demand for coin grew so large that notes went into a discount of 6-8 annas per cent.² The local District Officer reported that once bazaar purchases had been

1. Report of the Controller of Currency, J.B. Taylor, for the year 1929-30 under Appendices to Report, Chapter 'Cotton Finance'.

completed peasants removed any surplus back to their villages in whole rupees and were quite prepared to pay the small discount demanded by bazaar shroffs in the area.

When either coins were not available or the price of bullion dropped the cultivator purchased bullion.¹ In localities, where money transactions were carried out at a considerable distance from Government credit agencies, silver substituted rupees as a token of currency. In 1923-24, it was especially noticeable that the proportion of silver in Barsi Nagar and Central India area was


"In 1922-23, 1923-24 and 1924-25, the rise in the gold value of the rupee, substantially above the pre-war rating, gold has lately been cheaper in India that at any time during the past generation. It is, therefore, no matter for surprise that imports of gold have recently been on an unprecedented scale."

See also, Kitchen, 'Consumption of World's Gold Supply', Appendix p.535.

In 1923, when the active export of commodities strengthened exchange, the C.C. reported:

"... We must be prepared, I think, for large bullion purchases in London the volume of which will tend to increase with every rise in exchange and consequent cheapening of gold."

D.C. from Denning to Fin. Dept., January 18, 1923, File No. Accts & Fin. - May 1923, Ns.60-126, Part A.

In 1925, the price of gold, during the latter part of the year, was actually below its pre-war level, whereas in the same period the general prices were about 70 per cent and prices of piece-goods about 100 per cent above the pre-war level. In these circumstances, it was natural that the surplus money should, to a very much larger extent than was usual, have been put into gold.

McWatters to Dinshaw Wacha, loc.cit.
comparatively high in relation to all other currency. Not only was this because of the lack of adequate facilities for encashment of notes, the area was also situated in Hyderabad State where the operation of indigenous brokers went entirely unchecked.

**Bullion Prices**

When the price of bullion dropped in 1923-24, 1924-25 and 1926-27 catalysed by the manipulation of the exchange rate, bullion began to substitute coins in hoards in a significant fashion. The inducement to the cultivators to convert their store of value from coin to bullion, was large enough to release hoarded coin in the 1926-27 busy season, increasing the velocity of circulation of currency.¹

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¹ The depressed price of silver, was a direct result of the policy of the Government to sell excess silver held in the paper currency reserve that had been re-valued on the 1s6d rupee, for the purpose of creating interest bearing securities on the sale of the proceeds. The Marwari Traders Association pleaded that coin silver prices disturbed trade conditions and encouraged the agriculturist to buy silver.

"... cheap price of silver in terms of rupees tempts people to buy silver instead of manufactured goods. Consequently, both import trade and local industry as also internal trade seriously affected."

Sale of silver also involved an overall contraction which further accentuated these difficulties. Telegram from Secretary Marwari Traders Association, Calcutta, November 12, 1926, File No.72-F/1926.
This release of metallic currency precipitated the number of local reports that were submitted to the currency offices in Bombay and Calcutta. As discussed earlier, these reports exaggerated the overall importance of the popularity of notes and the apparently weakening preference for coin. Such empirical data was of little help because ephemeral trends in monetary preferences varied the ratio between coin and notes and not necessarily indicating a re-orientation in the peasant's demand for coin and bullion.¹

¹ The depression years generated an unusual demand for money.

The precipitous drop in agricultural prices encouraged the sale of distress gold. Gold disgorged itself from hoards and was exchanged for coin which raised the percentage of coin/note absorbed, from 22 per cent in 1930-31 to 61 per cent in 1931-32. Whether this was a result of a general mistrust in fiduciary currency at a time of general economic upheaval is debatable. Certainly, the absorption of coin was unusual at a time when the agriculturist's profits had dropped sharply. However, coin absorption was because of a drop in the price of bullion which was responsible for the huge coin absorption; that altered the normal preference in money supply. It was the over-valued rupee, the high exchange that depressed bullion prices complicating monetary stability.
Monetary Habits and Industrial Enterprise

Primitive agricultural preference\(^1\) not only complicated monetary policy and confused currency officials, it was also enormously damaging to the growth of urban industry. Industrial enterprise as a result was forced to depend on its internal resources for finance, because of a credit structure that suffered from a seasonal oscillation and was regulated by primitive monetary habits. Such a structure of credit was unable to promote industrial efficiency or growth.

What must have been particularly harmful to indigenous industrial development were the irregularities in the structure of organised credit itself, that had been generated by the Government priority of exchange control.

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1. For instance, stock market activity and speculation developed as an adjunct to commerce and the distribution of goods can have an effect among other things on the size of local wheat, jute, cotton or rice markets. Such characteristics are entirely peculiar to an agricultural economy.

The effect of speculation on the size of a crop market can be aggravated by:

A. Rampant speculation that produces unnatural fluctuations in staple prices;

B. The lack of regulation and connection in staple markets.

Speculation and agricultural commodities could grow so serious that branches of chambers of commerce from the large urban trade centres would be established in local markets to arbitrate and establish custom and regulation of speculation and so control the more extreme fluctuations.
The Exchange Rate and Monetary Imbalance

It was the peculiar arrangement of a seasonal economy that extended the influence of the exchange and aggravated money conditions.

When in December 1927, the Bank rate was raised to 6 per cent, as money was growing tight, exchange strengthened and the Government stepped in to purchase large amounts of sterling. As a result of these sterling purchases, an equally large quantity of rupees was released into the economy and the market rates for money in the bazaar dropped below the Bank rate, creating an unusual dissociation in the general supply of credit.


   D.O. from Denning C.C., December 9, 1927, Ibid.
   The strength of exchange was sufficient to postpone a large sterling loan for 5 million that had been proposed by the S.S.
   "In view of the recent large remittances and strength of exchange, there seems little doubt that we shall be able to make sufficient remittances through the market to meet S.S. requirements without fresh borrowing in London...."
   Telegram from C.C., December 15, 1927, Ibid.

3. The dissociation was large enough for money to fall away from investment in Govt. securities, and escape to London where such funds were attracted by the sale of sterling investments in London. Norcot Warran was anxious to prevent the Govt. from borrowing extensively from the Bank as he was -
   "... reluctant to see the hidden reserve of the I.B.I. largely decreased."
   D.O. from Denning, December 9, 1927, Ibid.
The dissociation between Imperial Bank credit and the bazaar rates for accommodation, though generated by the exchange rate, had little to do with the rate of exchange or the purchase of sterling. A rise in the exchange rate occurred when trade accelerated and sterling balances accumulated rapidly in the hands of the Secretary of State in London. These balances in the form of Council Bills increased the relative proportion of sterling to rupees, and the exchange rate of the rupee strengthened. However, the acceleration of trade which touched off the positive sterling balances, almost always meant larger and larger requirements of finance for the movement of crop and raw agricultural commodities for the export trade. Given the preponderance of the Imperial Bank that undertook between 40 per cent to 55 per cent of the total volume of crop finance from all sources, an acceleration of the export trade meant a depletion in the cash holdings of the Bank. A drop in liquidity would justify a rise in the Bank rate.

Hence, it was not only the position of the Imperial Bank over trade finance where no other bank in the organised money sector contributed as hugely to crop finance, but also a fluctuation in exchange that was responsible for the dissociation in rates. This quite simply was attributable to not only the Bank's larger
resources, but to the Government's need to guarantee, through the Imperial Bank, the smooth finance and movement of the export of agricultural staples.¹ The Imperial Bank's willingness to expand well into the hinterland and establish branches where no joint stock bank could afford to maintain credit facilities, gave the Imperial Bank an effective monopoly over the finance of commercial crop. Given this, then once the busy season commenced, a drain of cash occurred at Imperial Bank, but nowhere else in the organised credit sector was the lack of funds acutely felt.²

1. The I.B.I.'s role in promoting the movement of agricultural staple from hinterland to port is acknowledged by Indian Joint Stock Banks in an answer to questions put to them by the Indian Central Banking Enquiry Committee.

See, the Indian Central Banking Enquiry Committee Report, Vol.II, written evidence, a fairly typical reply can be had from evidence submitted by the Andhra Bank, p.19, a summary:

"This Bank (I.B.I.) is the principle medium of the transfer and movement of crop to the ports where the actual export to foreign countries is undertaken."

Though acknowledging the services of the I.B.I. in marketing of staple for export, the Indian Joint Stock Banks are universally critical of its other credit functions.

2. See, 'The Seasonal Pattern for Cash in Schedule II Banks', B.M.S. See Appendix IV.
Hence, at a time that the cash position of the Imperial Bank dropped to critical proportions, rupees released in exchange for sterling flooded the bazaar and lowered bazaar rates. In 1925-26, another boom year for the export trade, the price of jute was exceptionally high and the amount of money required to finance crop was very much larger than usual.\(^1\) By September, the cash balance of the Imperial Bank decreased very rapidly and on the 24th of September, it was found necessary to raise the Bank rate from 4 per cent to 5 per cent; as an indirect result of heightened trade activity in jute, among other commodities.

There was, however, a plentiful supply of funds in the market. Heavy purchases of sterling by the Government had released rupees into the hands of exchange banks and large export houses, and the Bank rate had little effect on the market rates.\(^2\) The Imperial Bank, on the other hand faced with a growing demand for cash, had actually

\(^1\) Report of the Controller of Currency, H. Denning, for the year 1925-26, p.17.

\(^2\) This was because of the heavy purchases of sterling initiated by the Government because of a strong exchange. File No. 42-11-F/1925.
to expand currency by 3 crores to prevent the Bank's cash position from falling to an unduly low figure.¹

This rather peculiar monetary dissociation within the structure of organised credit increased the part played by bill-broking.² Banks not as intimately

1. This was done on December 4, 1925 against £3,000,000 worth of British Treasury Paper that was transferred from the Treasury to the Paper Currency Reserve. The healthy exchange position allowed the Treasury a temporary over-supply of £ sterling in excess of the S.S. requirements for that month.

Telegram from Controller of Currency to Fin. Dept., December 2, 1925, File No.42-11-F/1925.

The Indian Central Banking Enquiry Report went as far as to examine the divergence between the rates on the organised and un-organised spheres of credit. The dissociation is symptomised by this divergence, though there remains a great deal to be said about the nature of this dissociation between organised and indigenous credit; See, I.C.B.E. Report, Vol.I, Part I, p.400.

2. To some extent the Government in order to make the control of credit more elastic encouraged bill-broking especially in regard to the sale-purchase and re-purchase of Government securities. When the S.S. advised that the Government must attempt to do without T.B's during the busy months of the year, and not overload their liability to the money market, the GOI objected saying that T.B's were an inseparable part of any scientific monetary system.

"Not only do they give Government cheap money, but they enable it to control credit in a manner that is open and above board and also tend to develop a modern financial machinery represented by bill-brokers, which is lacking in India...."

D.O. from J.B. Taylor C.C., June 24, 1929, File No.5(2)F/1929.
involved with the finance of commercial crop (as the Imperial Bank), faced with unusual and seasonal accumulation of surplus funds, invested their money in short and call notice loans to the stock exchange and the bill market, and not directly with traders and middlemen.\textsuperscript{1} The stock exchange and the bill market acted as intermediaries, issuing bills and hundis of their own, establishing money brokers in an influential position in the regulation of almost all credit supply that the Imperial Bank did not have a hand in. Money market and stock exchange activity was, as a result amplified by irregularities within the structure of organised credit.\textsuperscript{2}

When exchange weakened a similar dissociation in the money market did not occur. In January and

\begin{enumerate}
\item The increased role played by bill-broking is directly connected to the failure of the I.B.I., and later the R.B.I. to link the indigenous bankers either directly or indirectly with a bill market financed by organised credit. Even the I.B.I. bill operations were conducted on terms that would be unacceptable to other Joint Stock Banks and to the R.B.I. after 1935. Hundos were not properly scrutinised, indigenous bankers kept no properly audited books of accounts, nor did they permit I.B.I. officials to inspect them, periodical account statements were not demanded. Thus, the I.B.I. was forced to operate through brokers known to them which amplified their role as intermediaries.
\item See also, V.R. Oervante, op. cit., p.39, Chapter 'The Unorganised Sector of the Capital Market'.
\end{enumerate}
February 1926, \(^1\) banks that had supplied themselves with funds by selling sterling to the Government, found themselves unable to purchase rupees, as exchange rates had weakened. \(^2\) This inability to obtain funds from the Government's purchase of sterling, transferred demand for funds to the short money market. The large demand for currency pushed the money rate for call and short money up, and the rate settled close to the level of the Bank rate.

In contrast, the now sympathetic relationship between the Bank rate and the money market rate had healed the earlier fracture between the rates and the

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1. The reason for the weakening of exchange was because of the import of bullion, combined with speculation in Bombay on bullion prices. By April of the same year, bullion prices and the sentimental effect of the sitting of the currency commission, sagged exchange to such an extent that the Government was prepared to sell sterling to steady exchange.

   Telegram to C.C., March 19, 1926.
   Telegram from I.C.C. Calcutta, March 18, 1926, Enquiring about fall in exchange.
   Telegram and Endorsement to C.C., March 20, 1926.
   Telegram to S.S., March 20, 1926.
   Selling Sterling, D.O. from C.C., April 9, 1926, File No. 53/F/1926.

dissociation was now absent. The sympathy between the two rates was because, once the Government refused to buy sterling, the bazaar had no immediate and alternative cash resources. Had there been falling trade and reduced commercial activity, then the finance of crop would have been sluggish, and despite the willingness of banks to have invested in money at call (temporary stringency would have existed as there was an overhang between fall in commercial activity and a drop in demand for short funds), the amount of currency in circulation in a bad season would have been much less than in a season of active trade demand. In 1925-26, the seasonal expansion of currency required for the finance of the cotton crop was only 9 crores as against 14 crores in 1924-25 and 24 crores in 1923-24.\(^1\)

The decline in the volume of currency usually fell more precipitously than the demand for currency and, as a result, money market rates were forced up and acted in consonance with the Bank rate. If so, then the Imperial Bank which controlled the existence of surplus or deficient funds for the finance of crop,

forced bazaar rates to move in sympathy with the Bank rate; in times when exchange fell, it could not have been otherwise. 1

Given then an absence of alternative sources of currency caused by a drop in exchange rates, the influence of the Imperial Bank's seasonal finance of crop, on the money market, was by no means negligible. The fluctuation in the exchange rates was emphasised only to illustrate the dissociation that could occur between the market and the Imperial Bank, if and only if, additional sources of finance dulled the normally very persuasive influence that the Bank could command over organised credit. 2

1. The rates on the unorganised market are too divergent to be able to quote a consensus rate for any one month of the year. However, the bazaar bill rate is the rate at which organised credit lent funds to bill-brokers who floated bazaar bills, and can be taken as some indication of the fluctuation in the indigenous credit rates. See Appendix III.

2. Imperial Bank and the Money Market:

The Imperial Bank's ability to exercise this influence stemmed from the money market's dependence on currency released from crop finance. The position of the market in relation to the overall circulation of money during a typical busy season made this influence inevitable.

This hypothesis that has not been based on empirical evidence. However, it is not irrational to deduce that the seasonal finance of crop regulated money rates and extended the influence of the Imperial Bank over the urban money markets.
Apart from industrial development that was hampered by chaotic and indisciplined money conditions, currency officials themselves could barely control an abundance or a stringency of money; they would have an extraordinarily uncomfortable time if exchange persisted in dropping below or remaining above gold point.

During the soaring prices of the war years, the percentage of cash to the deposit liabilities of Indian banks reached record levels. In ordinary circumstances, unusual accumulations of cash occurred, either because of recall and non-removal of loans or excess of payments, in over-withdrawals.

In times of great trade activity and business profit as the war years were, such occurrences were out of the question. The unusual growth in the liquidity of the banking system was because the Government accelerated the creation of currency to liquidate the huge positive trade balances accruing in favour of India through Council Bills in the hands of the Secretary of State. Each wave of currency that flooded the economy, generated a fresh rise in the level of prices. What was

important however, was that the enormous expansion of currency enforced an equally large demand for silver without which notes would not have been allowed into circulation.

**Money Stock and Prices**

The dilemma, itself a consequence of colonial monetary policy, does not subtract from the important deduction that cash in terms of coins played a very important part in the circulation and distribution of commodities.

The bulk of transactions were settled in cash, which formed the greatest part of the total supply of money. Since this was so, the most important source of change in the money supply could only have been a variation in the supply of cash. Unlike the monetarily more sophisticated industrial economies where credit amplified the function of cash to such an extent, that huge imbalances could be generated. In the Indian economy, as market transactions were conducted in cash, the changes in money stock occurred as a direct consequence of the supply of precious metal, foreign trade in bullion or changes in the Government issue of currency.¹

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¹ Eventually the Government issue of currency was determined by the supply of precious metal, either silver or gold. During the war when India's high positive trade balances made a massive expansion of currency necessary, the Government soon found that it could not continue to issue fiduciary currency without sufficient metallic backing. The Viceroy telegraphed the very serious position that the GOI would be in if threatened by inconvertibility of its currency.

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It is not impossible under such circumstances for changes in the Bank rate to have caused disturbances in the price situation; but changes so initiated could not have been violent or prolonged unless they were supported by parallel changes in the mintage of coins and notes. An increase in lending by banks to cultivators would have produced inflationary effects of the usual kind, but inflation would have been checked, if there were not a great increase in cash forthcoming, to support the increased pace of transactions.

Accordingly, since banks and banking activity were concentrated in urban centres, contact with banks

(Footnote contd...)

"A further result would be that the confidence in the expansion of our note issue, which as you are aware has been of invaluable assistance to us during the difficult conditions with which we have been recently faced, would be for many years seriously impaired and as far as concerns the immediate future, our notes would be forced by the shock to a discount of a material and probably increasing amount."


During this period, it was not credit that determined prices, but the note circulation which determined both prices and demand liabilities of scheduled banks - demand liabilities have expanded with the expansion of the note circulation.
was generally confined to the traders in those centres. A bank-generated inflation was, therefore, liable to mean development of speculation and investment in those urban centres alone.2

The presence of trading contacts between the inflationary urban centre and the hinterland, would have led to a higher price for agricultural commodities. This seasonal drain of cash from the urban trade centre would have rapidly checked a bank generated inflation, unless increases in the supply of money were overwhelming or exchange rose persistently over upper gold point.

**Long and Short Rates**

The amplitude of the seasonal cycle was by any standards substantial. Alternating conditions of light and plentiful money must have agitated industrial activity in the economy, disturbing the cost of holding stocks, the availability of raw material and most of all, the supply of working capital.

1. Especially the great ports; Bombay, Rangoon, Calcutta and Madras and the three great up-country centres of trade, Lahore, Kanpur and Delhi.

2. The development of speculation or investment at times when money was in abundance.
Additionally the flow of investment into industry was handicapped by a weak money market. Public preference and the buying and selling of shares on the stock exchange was subject to the handicap of a weak money market. Public preference on the Indian money market played an important political role, but the number of channels into which investable resources could flow was restricted and a speculator's room for manoeuvre was very small. There was a definite bias in the Indian money markets towards gilt-edged Government scrips, as industrial investment was fraught with unknowns and though returns could be high, the risk which accompanied such speculations was always present.¹

The peculiar relationship between short and long rates in India reflected this unease about industrial investment very strongly.² Indian bankers had a preference


² This occurred especially in times of disruptive speculation in industrial shares. For instance, in 1926 the Controller of Currency reported extremely favourable conditions for the floatation of the annual rupee loan of 1926. The reason was that after the collapse of the war boom in 1921-22, industrial shares were subjected to bear speculation that seriously unsettled the money market. The result was that larger quantities of cash entered the market for Government scrip. The Controller of Currency reported that:

...contd./-
for bills of exchange and short-term paper, because the risks involved in loans granted for longer periods were manifold. A shorter dated loan was easier both to assess and to evaluate its credibility, as it depended on the movement of trade which, in normal circumstances, guaranteed a certain return from profits realised. Long-term loans required an infra-structure or an ability to calculate the enormously more complicated twists and

(Footnote contd...)

"The public distrust of industrial issues brought about by the large losses incurred in industrial investments during the last three or four years, still continued and for some months there had been a growing demand for Government securities while supply of such securities was less than normal."

During the inter-war period, the difficulties that Indian industry was faced with greatly magnified this scrip.


A similar distrust occurred in 1922.


1. Indian Banks failed to forge a link between savings and investment in industry. They financed trade through short-term paper, which to that extent set capital free for investment in industry. The majority report of the Central Banking Enquiry Committee discusses capital requirements of industries and the limited nature of assistance provided by Joint Stock Banks.

turns of circumstances to be profitable on a large scale. Either the banks themselves, or some specialist intermediary guarantors would have had to pass judgement on the credit-worthiness of borrowers for long periods ahead.\(^1\) This was a crucial difficulty for the Indian banker. It was infinitely easier to say of an industrial firm that it would still be solvent in 3 months time, than it was to say that it would be solvent in 20 years from then. It was the enormously increased risk of loss due to the particular difficulty of foreseeing the credit-worthiness of borrowers far ahead, as well as to the uncertain effects of interest rate changes that made bankers avoid the long-term capital market.\(^2\) Industrial capital came from re-cycled profits of managing agents, or were entirely subscribed by staking the personal prestige of an entrepreneur in guarantors for borrowed capital.

As a direct consequence, long-term rates in the Bombay and Calcutta money markets were not measured from industrial securities or from the demands for the

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1. S.K. Muranjan, *op.cit.*, p.55, Chapter 'The Structure of Interest Rates'.
   See also, H.T. Parekh, 'The Bombay Money Market', Chapter 'Interest Rates'.

finance of long-term capital projects. The long rate was determined by the only reliable form of long-term investment on the money market - the rupee loans and un-dated Government paper.\(^1\) As the rates for long-dated 'gilt-edged' securities were much lower than normal rates on the exchange, the proper relationship between long and short rates in India was the reverse of money rates in the London and New York exchanges.\(^2\)

The supply of short-term credit in the market was, to an extent, self-regulating and the Imperial Bank was unable to refuse to renew credit, because otherwise there would have been a huge fall in purchasing power and the export economy would have been thrown out of gear.\(^3\) This pressure on the short-term market kept the premium on short-term capital high and well above long rates.

\(^1\) H.T. Parekh, op.cit., pp.146-47, Chapter 'Interest Rates'.

"When we speak of short-term interest rates, we generally take as our measuring rod the rate of interest ruling on treasury bills. Similarly, when we talk of long-term interest we take our basis the rate of interest ruling on the longest dated Government loan."

\(^2\) S.K. Muranjan, op.cit., p.58. See also, H.T. Parekh, op.cit., p.156, for a comparison between interest rates in Bombay and Calcutta.

\(^3\) Imperial Bank and the Bill Markets; a short paragraph in H.T. Parekh, op.cit., stating the importance of the bank in providing credit to trade, p.24, Chapter 'Joint Stock Exchange Banks.'
In a normal capitalist economy, had long rates been persistently below short rates, the general demand for such capital would be very high. The higher marginal efficiency of capital, and the highly elastic demand for low interest capital would normally have stimulated a very large inducement to invest.¹ In India, given the small number of investment possibilities on the Indian money market, the demand for capital was not normally interest-elastic.

I. Money Supply and Interest Elasticity of Capital 1880-1890

There were exceptions to this rule. There occurred very significant breaks in inhibiting money conditions during which capital investment did take place. During the 1890's when the Victorian economy was passing through an industrial depression, money rates in India eased considerably.² The short rates fell suddenly below long rates in 1891 and 1892, indicating a shortfall in

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¹ This is quite clearly brought out in 'The Indian Capital Market', V.R. Cirvante, University of Bombay publications, Economics Series No.6, Editor, C.N. Vakil, pp.6-7, Chapter 'Marginal Efficiency of Capital'.

² Report of the Indian Currency Committee, 1898, known as the 'Fowler Committee', pp.88-89.
commercial activity in the seasonal export of agricultural raw material in 1888, 1889 and 1890, and the average rate of the Bank of Bengal was 5.460, 6.990 and 5.790. For 1891 and 1892, the average dropped to 3.062 and 3.499. The rates of the Presidency Banks of Bombay and Madras plummeted as precipitously, and although rates subsequently rose above long rates, money conditions continued to be easy from 1893 to 1896.\(^1\)

Whatever the intrinsic reason for the unusual ease of monetary conditions, in this case, because of heavy imports of silver, the fall in short rates in India was coincident with a well marked investment boom.\(^2\)

With the general fall in interest rates, enterprise began to gather strength. From 1890 to 1893, the paid-up capital of joint stock companies increased at a moderate speed. But thereafter till 1898, it mounted up at a rate which, for those years, was astonishing.\(^3\) The floatation of joint stock companies was quite surprising, as a glance at the linear graph on

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1. B.M.S., op.cit.
3. B.M.S., op.cit.
the paid-up capital of joint stock companies, would show that in sympathy with the falling interest rates and the progress of the investment book, prices rose rapidly, the index number rising from 97-100 in the decade 1881-1888 to well over 115 in 1890-96.¹

A word of caution: - There is little doubt that the investment boom was sustained more by the depression in the metropolitan economy, rather than by the plunge in interest rates here in India. Paid-up capital increased more in the latter half of the decade, when there was a noticeable drop in the prices of imported and exported goods to and from the Indian market. Not only was there a depression in commercial activity associated with the movement of crops and the export economy, but equally important, this was a consequence of a serious depression in England, whose trade with India suffered.²

It was at this time when imports from Britain had fallen and an unsatisfied demand was generated in the Indian market that an extension of indigenous manufacturing capacity occurred. Elasticity of capital

¹. Commercial Intelligence and Statistics Department (CISD) Index Number of Indian Prices 1861-1931 and annual review of prices... supplement 1939, Calcutta.

². For depression in Great Britain, see, E.J. Hobsbawm, 'Industry and Empire'.

to interest rates may have increased, but this can only be justified when specifically related to a monetary incident in the Indian economy. When the Government took steps to correct the money rates imbalance, investment came to a stop only in 1899 through money rates returned to their normal levels in 1897, and prices in 1898 when the index number dropped to 109 in 1898 and 99 in 1899.

Historically, however, the situation was not so simple. It would help for the sake of clarity to dissociate what could be called:

(a) the trade imperative
(b) the monetary incident

(a) The Trade Imperative

This is, essentially, the argument that industrial expansion could not have occurred till the inhibition of the trade connection was removed. Tariff laws favouring imported goods, and a dependent economy unable to support extensive industrialisation imposed a peculiar pattern of trade. The depression in the metropolis, reflected by the prices of imported and exported goods here in India and the fall in the quantity of imported commodities temporarily dissociated English manufacture from the Indian market in the 1890's. An investment boom and the extension of industry was the result.
The Monetary Incident

The drop in interest rates, formed a protective bubble, in which industry could grow by attracting funds for industrial investment. This drop in interest rates was generated not only by a depression in the Victorian economy that slowed commercial activity in India. The fall in the silver exchange made silver cheaper and touched off heavy imports of the metal. Between 1889 and 1894, net imports of silver went up by 50 per cent when compared to the preceding 5 years. Most of this silver found its way into banks, which then used silver to add to their cash, or coined it into currency and expanded the circulation of notes.

Circulation jumped from 15.19 lakhs of rupees in the years between 1886-1890, to 27.45 lakhs. It was this 80 per cent increase in the circulation of notes that accounted for the precipitous drop in interest rates.

Clumsy monetary management aggravated the situation, though the Government closed mints as early as 1893 to correct the interest rate imbalance and the excess of


2. Report of the (Herschell) Committee of 1893 on Indian Currency and Finance, pp.11-12, Chapter 'Recent Imports and Coinage of Silver'.
coined silver in circulation, the Secretary of State insisted on rates for council bills that were much higher than market rates and this forced an even greater import of silver.\(^1\) Subsequently, after two successive reductions in rates, the Secretary of State re-established touch with the market in January 1894, and released large quantities of rupees which had been impounded in Government treasuries from June 1893 to January 1894.\(^2\) The improvement in the exchange rate, in the meantime, tended to defeat itself by calling rupees out of hoards for the purchase of apparently cheapening silver and the withdrawal of the Government as the largest borrower in the market intensified the trend to lower rates.\(^3\)


Uncoined silver dropped in price because of the closure of mints and the Herschell Committee suggested a duty on imported silver, p.47, op.cit., See also, p.49, provisions against a sudden rise in exchange, i.e. further cheapening of bullion silver.

2. See, Fowler Committee Report, p.70, graph that illustrates the exchange rate of the rupee which achieved parity with the official exchange rate in 1894.

3. This is self-evident; as soon as exports rose and a greater amount of sterling was released into the economy, the Indian exchange rate would rise reducing the premium on coined silver, bringing it back into circulation. However, quantities of uncoined silver would be even cheaper depending on imports of the metal and demand would remain as strong.

See, above graph which gives figures of gross exports from India 1887-1899, p.170, op.cit., loc.cit., Ibid.
It was only as late as 1898 that monetary stringency had some effect on rates of interest, though the investment boom did not come to a stop till 1900. The lag is acceptable as the time required to float an industry would tend to overhang a drop in interest rates.\footnote{B.M.S.}

Given both the colonial imperative and the monetary incident, this analysis would suggest that the colonial imperative determined and created the climate required for investment that was catalysed by a monetary incident which lowered rates of interest. This purely deductive impression is strengthened by a subsequent investment boom during the great war of 1914.

II. Money Supply and Interest Elasticity of Capital 1914

During the war, India and the Indian market were very firmly cut off from the import of industrial manufactures. The export economy denied the shipping tonnage and the usual foreign demand for its commodities sunk into temporary depression.

However, the Government of India forced by the blockade of imports to rely more and more on indigenous manufacture, forced a renewed pace of commercial activity
by 1916 to supply its growing war effort. By 1917, the European theatre of war had added to the Government of India's own demand for commodities and trade and commercial activity multiplied many times over, reaching a peak in 1919.¹

Much of this war demand was paid by an exceptional demand by the Government for savings of all kinds. In the years 1917-1919, the Government borrowed Rs.130 crores, and pressure of this demand and the growth of war investments forced the long rate up from 3.8 per cent to 6.2 per cent in 1922.²

This abnormal rise closed the differential rates between long and short loans and strikingly increased the proportion of current to fixed deposits during the

1. This caused a general and rapid rise of prices, and as a result of the immense creation of credit currency in all the principal countries of the world. £100,000,000 piled up in various reserves and balances to the credit of India, in London. "India became the cheapest source for many raw materials and Indian imports fell off not only because of the scarcity of shipping but also because things were too costly to buy from other countries."


war years. By 1921, the relationship between long and short rates had reversed, catalysed this time by very large inputs of cash into the economy that lowered the premium on short loans.¹

It was during these four years until 1921 that investment accelerated, and paid-up capital in banking, insurance and manufacture rose very rapidly.² In the great war scenario it is more difficult to theoretically dissociate the trade imperative from a monetary incident. Till 1915, the break in trade precipitated a depression which, however, blossomed into a boom with the war demand. The war demand for commodities was an imperative strong enough to break the colonial bind on Indian industry and accelerate indigenous manufacture.

The monetary incident was more complicated and more closely interwoven with the demand for commodities that the war had set in motion. Nevertheless, it was

1. The rate of the Imperial Bank on demand loans represents earnings on short-term investments; however, for short rates the best bet is the rate on 3-month treasury bills. See Appendix.²

2. B.M.S., Section 8, "Money Rates and Security Markets", Tables 37 and 38, pp. 780-84. 'Number and Paid-up Capital of Joint Stock Companies at Work'.
eventually the demand for silver and its unavailability, that generated a large surplus of funds in the money market that lowered the short rate till 1921, well after the Government had begun to take stringent measures to deflate the economy. The problem of surplus cash was so serious that while the Government was withdrawing crores from circulation, the deposits of the Imperial Exchange and Indian Joint Stock Banks increased in the very same months by 23.5 crores. It was this huge floating reservoir of funds that kept exchange high, lowered short rates and was partly responsible for the investment boom that was set into motion in 1918.

1. Probably the greatest recorded inflation in the history of colonial India was during the great war when the active note circulation rose from 49.97 crores on March 31, 1914 to 133.59 crores on March 31, 1919. The gross circulation of one rupee notes which were first issued in December 1917 increased from 32-3/4 lakhs on March 31, 1918 to 105-1/2 lakhs on March 31, 1919. The absorption of silver coin during the five years 1914-19 was 110.39 crores, as compared to 43.91 crores during the five years from 1909-1914. The rise in the circulation of money, both note and coin, was nothing short of phenomenal.


2. B.M.S., Section 2 Table 1 and Tables 3 and 4, pp.30, and 96-144.
Conclusion

This general pattern survived till the end of our period where the seasonal crop movement and the trade associated with the export of commercial crop, dominated the economy so strongly that almost all economic indices were carried on the same seasonal pulse. In both the 1890's and 1916-19, the extension of paid-up capital can be associated with a drop in interest rates, but as we saw this drop in interest rates could not be determined in industrial growth during those years. The influence of interest rates, in a seasonal economy was handicapped primarily by the nature of the export economy – its busy and slack season, flow and ebb of money. It was additionally qualified by features that were inbred such as the monetary duality, the reliance on bullion, the exchange rate, all of which define a monetary model perhaps not completely but certainly in part.

It would be tempting to define our hypothetical model as a backward agricultural economy that had been systematically perverted to encourage the export of agricultural raw material. The model stands out much sharper if it would be defined in contrast to metropolitans trade-cycle economies of the inter-war period. Take a simple feature such as the Trade-Cycle itself.
A rise in the Bank Rate which was a annual feature of the seasonal economy was not as traumatic an incident as in a trade cycle economy where it usually meant a heightening of liquidity preference at a top end of a boom. As a result the Bank Rate could fluctuate within 3 to 4% points and not dislocate the seasonal economy, primarily because the Bank Rate could not act on an economy where credit was a small part of the total machine of circulation and distribution.

The real purpose was not to draw a complete monetary constitution of the inter-war economy (which indeed would have been a stupendous task) but to illustrate the extent of Governments monetary concern over the stable exchange and the consequences that were generated on an economy dominated by an annual agricultural cycle.

The political agitation that was churned up to fight the official attitude towards exchange never really saw the breadth and scope of official interference with money policy. As a result the exchange agitation picked up momentum among the industrialists but never gained the respectability of a national issue. It always remained a sectarian demand which judging from the magnitude of the monetary problems it never should
have been. A simple fact of a fixed exchange not only acted irregularly on a seasonal economy at home it was also tied up with the entire question of the metropolitan remittance mechanism. This is where our story will take us to next.