CHAPTER ONE: THE EXCHANGE DEBATE

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Prologue

As early as 1919, it became increasingly obvious that the pre-war currency arrangements could no longer function with any efficiency. Some sort of machinery had to be put together to be able to handle the vast upset that the war boom had precipitated. Whatever could ensure some measure of monetary equilibrium could at best be some sort of compromise between the official position and its detractors. The evolution of this compromise generated a wide ranging debate that not only revealed the very obvious defects of the pre-war rupee, but also threw into sharp relief a whole spectrum of both official and unofficial interests. The India Office sought to tie the rupee to sterling as long as it continually appreciated. The Government of India acquiesced but only if the monetary consequences did not generate unmanageable political tensions. The commercial and industrial community desperately needed greater liquidity and demanded reflation. The radicals among them and the Congress wanted the government to forswear interference and asked for an automatic currency. There were economists who claimed to suggest solutions on the basis of statistical research and their own weighty academic considerations. Others championed themselves as spokesmen of the undertrodden, the labouring classes, the
peasantry, the urban poor, and the middle classes: there were no dearth of solutions to the Exchange problem from what appeared to be every corner of society.

In spite of this, perhaps because of this, the 1s6d rupee was not determined by a simple consensus of the varied opinion on monetary reform. This chapter begins with an overview of the incompetent rupee and then traces chronologically a history of the exchange debate from the end of the first war through the Smith and Hilton Young Commission Reports. An attempt is made to analyse the debate and how it grew during and after the depression. The story of the rupee is undoubtedly interesting, because eventually it was an almost total disregard of the public outcry against the manipulated rupee that determined the government policy towards currency and exchange. Its inadequacy persisted and grew worse because the rupee was used to preserve exchange equilibrium and the fierce disturbances that were generated were defended as short term contingencies that had to be borne with. Neither the exchange debate nor the currency agitation could break the official unwillingness to consider reform. This in an age where an active nationalist movement was supposed to have forced substantial concessions from a sympathetic
government, does not mix well with the current notion of a weakening Imperialism. Perhaps in some ways, the inter-war years offered more an illusion of reform than the constitutional concessions and the apparent devolution of power would suggest.
The Incompetent Rupee

The war disturbed the international monetary mechanism so severely that the arrangements that perpetuated the pre-eminent position of Sterling, threatened to come unhinged. For a time the Government of India could no longer guarantee a free and unrestricted movement of capital, which for many reasons was considered the most important feature of India's monetary association with the Empire.¹

Almost all the official witnesses before the Babington Smith Committee held the same view; Sir Lionel Abraham and Mr. Gubbay had no hesitation in saying that the problem, as it appeared to them, was the greatest practical stability of the rupee in terms of the Sovereign.²

1. The rupee as a dependent currency was used by British Imperial authorities in support of what can be roughly called 'colonial liabilities'. It serviced home charges and sterling remittances; it acted in support of sterling in guarantee of investments made with the backing of the bullion reserves and so on. Its status as a dependent currency made it subject to political influence that compromised its function as a monetary standard of a gradually industrialising economy. The Chamberlain Commission considered that the cardinal feature of the Indian system was 'the absolute security of the convertibility into sterling of so much of the internal currency as may at any moment be required for the settlement of India's external obligations'.


   Marcello de Cecco, Money and Empire.

   Susan Strange describes the British-Indian Rupee as a 'master currency in disguise' Susan Strange, Sterling and British Policy, p.9.

2. Babington Smith Commission Report (1919), Report Volume,
Para 36.
Bahington Smith himself recommended the linking of the rupee to 2s gold in order to compensate for the huge positive balance of payments that was accruing in favour of India and to ensure that the transfer of resources to the metropolis remained undisturbed. The Government of India confronted with a persistent India Office, its own home charges, and the political necessity of maintaining low prices, repeatedly manipulated the rupee, and from 1926 onwards pegged it at what many considered an artificial, inflated exchange rate. It was government influence and political meddling that became one of the principal issues between the commercial community arguing for industrial progress, and the government arguing for the larger interests of the Indian people.

Imperial considerations apart, there were important monetary developments that influenced the entire question. Parity of exchange at whatever level, it must be recognised, was an international and not a national problem. Stable exchanges between any two countries, or even a group of countries, cannot bind up international commerce, while exchange ratios in other countries continue to fluctuate. This is because markets of the former would be subject to constant exchange dumping on the part of the countries with inflated currencies. A reasonable solution would be sufficient control over currency to adjust rapidly the internal
value of the token to its external purchasing power, and if this is not possible at all times, then at best to seek a beneficial compromise between the two. It is the degree of fiscal and monetary control that is important in maintaining the much sought for 'parity' fixed by government supervision.

The Indian currency system was clumsy and inelastic. All the Government of India could do to prevent a rise in the sterling value of the rupee was to flood the country with currency.¹ The contraction of currency, when necessary, was much simpler, but it had troublesome consequences and was equally inefficient in rendering exchange equilibrium. Monetary remedies were at times so ineffective that the Government of India could only sit quiet and allow the natural growth of business to overcome political insecurity and chaotic finance.² The Indian standard of value (for reasons that facilitated the working of the Imperial system) was at the mercy of sterling. It was a dependent standard and a clumsy one at that.


It was to correct this imbalance that the commercial community were persistent in asking for an automatic standard that could only be achieved through a full-fledged gold currency bullion system, which would then allow Indian currency to operate in terms of 'mint par value' with every other currency.\(^1\) What the commercial community complained against was the system of dissolving balances of trade that was entirely handled by the Government of India, where the sale of Councils and Reverse Councils substituted the export and import of gold bullion.\(^2\)

Government manipulation and the degree of political influence brought to bear on currency questions in India was unusual. In pre-war England, France or Germany, currency arrangements were totally independent of the government. It was generally recognised that the political authority was not in a position to judge currency requirements of a country as well as banking institutions.

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1. IMC, BM0A, AMOA, and a host of other witnesses examined by both the Babington Smith and the Hilton Young Commissions held the same view.

2. For a complete account of the transfer and liquidation of trade balances, see J.M. Keynes, *Indian Currency and Finance*. The collected writings of John Maynard Keynes, Volume I.
in intimate touch with trade. When simple executive action could vary the value of the rupee it became more and more important to ensure its convertibility into bullion if the currency token was to be accepted as bona fide. The commercial community demanded that the convertibility of the currency be demonstrated with a gold token which would then automatically transfer the problem of exchange to banking institutions responsible for the export and import of gold and bullion. In India, the Government of India had taken upon themselves the entire task of providing the necessary supply of currency and adjusting it to the varying needs on different occasions. In an economy that required supervised seasonal inputs and withdrawals of currency the Government of India insisted that it had become increasingly

1. Any currency system will become automatic or 'elastic' if the currency token in terms of either rupee or paper is fully negotiable. In the fast industrialising countries of Europe where savings were serviced by large banking institutions, the convertibility of currency from token to bullion was not normally called into question. In India, where the level of economic activity was depressed, it was vitally important to those who saved to guarantee convertibility of the token into a commodity with a reduced tendency to fluctuate in value; gold was the answer.

   Report of the FICCI for the year 1932, p. 25
   Report of the FICCI for the year 1933, p. 23.
difficult to replace this system by an entirely automatic
gold bullion - currency exchange.¹

Apart from the more obvious Imperial priorities,
the reason surprisingly was the supply of gold on the
world market. During the war and after both belligerent
and friendly countries were jealous of their bullion and
it became next to impossible to persuade any country to
part with Rupees 108 crores of gold estimated as minimum
requirement for a currency standard.² The reluctance of
the Government of India to convert India to a gold
standard was in part deliberate. The monetary-bullion
resources of India were distributed geographically between
London and India. The Gold Standard Reserve and the Paper
Currency Reserves were operated as two different bullion
units, one in the charge of the Secretary of State and
the other was the responsibility of the Viceroy and his
Council.³ The large trade surpluses that piled up in
favour of India during and just after the war were

¹ Both the majority Reports of the Babington Smith
and Hilton-Young Committees insisted that the
conversion was not possible. Report of the
Babington Smith Committee (1919), Para 60.

² Figure estimated by Hilton-Young Commission.

³ J.M. Keynes, op.cit., pp.124-93.
converted and maintained as specie in the Secretary of State's Gold Exchange and Paper Currency Reserve.¹

These Reserves held in London amounted to considerable quantities of bullion and were regularly used to stand guarantee of the Indian Government's investments in Britain.² Undoubtedly, as a number of Associations and


2. It was the Fowler Committee in 1898 that first recommended that the gold reserve should be shifted to England. Lord Curzon and the then Finance Member, Sir Edward Law supervised the transfer of the gold reserve and placed it at the disposal of the India Office and the Secretary of State. Paragraphs 19 to 21 of Sir Purshotamdas's minute of dissent in the Hilton-Young Commission show how -

a) the Indian Gold Reserve was moved to London;

b) the Gold Reserve began to be called Gold Standard Reserve (how this gold came to be interpreted as securities saleable for gold);

c) arbitrarily the Secretary of State took for himself and the Council the power to invest it at their discretion in "consols or India stock or in any other manner."

The Gold Standard Reserve from 1900 onwards was used freely to stand guarantee for various projects including relieving the periodical recurrence of stringency in the London money market.


Chambers of Commerce alleged, this was a convenient but highly compromising use of India's Gold Reserves. The Bullion Reserve functioned both as a part of the British Treasury and as a backing for Council Drafts to liquidate balances of trade in India's favour. If the demand for a Gold Standard was actually legislated as a monetary reform, the entire reserve under the Secretary of State in London would have had to be shipped to India, disturbing financial arrangements made on its presence in London.

1. The original purpose was ostensibly to allow the Secretary of State to release Council Bills and Reverse Councils on the guarantee of Bullion Reserves located in London.

Purshotamdas Thakurdas, Private Correspondence and Writings on Currency and Finance, 1925-1932, P.T.Mss 55, p.82.

2. Nothing was more designed to arouse ill will against the GOI than the widely prevalent idea that the currency policy of the Government was determined more by the interests of the London money market than by the real needs of India. This plea was to become the battle cry of those who wanted to protest against the currency policy of the government. In a meeting held in the Marwari Vidyalaya Hall (one of many such meetings) under the joint auspices of the Bombay Provincial Congress Committee and the Swaraj Party, speeches by a number of eminent leaders reiterated this point. Shanmukham Chetty said rather bluntly -

"... one could not but feel the painful consciousness that the dominating idea in the report was not what was the best currency policy suited to India and her conditions, but how the currency policy in India could be arranged without causing any disturbance to other countries of the world."

*Times of India*, August 20, 1926, 'Stabilisation of the Rupee'.

..../contd.
Secretary of State was unwilling to do, and it added to the considerable reluctance of the Government of India to grant India an automatic gold exchange.

One of the most serious consequences of this arrangement was the dangerous division of responsibility for the control of credit and currency policy in the country. Because of the cumbersome duplication of Reserves, the government on occasion discharged its obligation to buy Sterling without any corresponding...

(contd.)

See also, 'Currency report condemned', Bombay's protest on what was colourfully called the financial Jallianwala. The members present at the meeting held in the same hall were Jamnadas Mehta, B.G. Horniman, Jamnadas Dwarkadas, L.R. Tairsee, Bhulabhai Desai, Ardhesir Subedar. Bombay Chronicle, August 19, 1926.

"... the reproach is made that the wishes of India are ignored and that India is being sacrificed to the whims of international finance."

Statesman, August 8, 1926, 'Always in the Wrong'.

1. Government unlike in other more developed countries of the world, exercised direct control over currency and note issue. The credit facilities available to trade and commerce were monitored by the government, and the Finance Department's clumsy working of the monetary standard was made worse by the duplication of currency reserves. There was often divided council and a failure to coordinate.

expansion of domestic currency. The purchases were made against treasury balances, but currency expansion was left to be effected subsequently at the discretion of the government and often never was. More serious was the absence of any automatic process of contraction when currency became abundant. Even when in order to support exchange, Reverse Councils were sold by government, there was no certainty of a corresponding contraction of currency being effected.

1. This was especially so in the early years of the 1920's when exchange fluctuation made it difficult to decide at what rate the cancellations or appropriations of rupee and sterling securities should be made. These largely informal arrangements were the joint responsibility of the India Office and the Finance Department and there were times when the deductions and additions through the P.C.R. and the G.S.R. were modified to suit the convenience of one or the other department to the disadvantage of money conditions in India.

Telegram from Secretary of State, November 9, 1921. Also note by the Fin. Dept./C.C., A.C. McWatters, November 18, 1921. Note by Auditor General, M.F. Gauntlett, November 29, 1921. Note by Fin. Dept., A.C. Mikherji, November 13, 1921. GOI, Fin. Dept. File No. Accts. and Fin. December 1922, Nos. 176-186, Part A, NAI.

2. At times the Gold Standard Reserve was used to borrow from instead of simply to withdraw from and when this happened, government increased their capacity to meet Sterling without making a corresponding contraction in money circulation. It was common practice when Reverse Councils were sold to meet them from surplus treasury balances in London and in so far as this was done, the rupees and notes paid in India by purchasers of Reverse Councils went into Government Deposits at the Imperial Bank and its cash ratio, thereby becoming a positively 'inflationist influence'.

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In 1920, when the government sold Reverse Councils on a large scale, the effect so far as a contraction of currency was concerned was practically neutralised by an increase in the aggregate deposits of the Indian Banking System to the tune of Rupees 23.5 crores. The system was not pliable enough and it seriously disturbed the purchasing power of the rupee.

In order to provide for seasonal variations of currency due to the demands of trade for the financing of the movement of crop, the currency authority had been allowed to issue currency notes up to Rupees 12 crores against 'hundies' to be placed in the reserve against note issue and had often to resort to inducing firms to finance themselves by bills against overdrafts in place of cash credits. These bills, although they represented a real demand for the finance required for trade, did not represent any definite goods or commodities, i.e. it was at best a clumsy method of satisfying currency requirements.

1. As exchange was strong and growing stronger with the rising price of silver, the money market could at any time ease a stringency by selling sterling to government. Any attempt to contract by cancelling rupees tendered for Reverse Councils would be self-defeating.
Another difficulty was the decision as to how currency should be expanded when necessity required it and what securities should be used to back expanded credits. Were the issuing notes to be attested against Treasury Bills put into the reserve in London or by issuing notes against 'hundies' in India?\(^1\) The Imperial Bank (since it did not gain anything by these loans in terms of a service charge) pressed the government for an increase in currency on bullion reserves in London. However, the Secretary of State, to keep his resources more liquid, did not wish to over-extend the Paper Currency Reserves more than necessary.\(^2\) Hence a


2. There was a constant tussle between the GOI and the India Office in London. This was most apparent during the busy season when expansion against ad hoc 'treasury bills' was undertaken by the GOI only with the greatest of reluctance. However, despite GOI's discomfort it was only on occasions when exchange was strong that the Secretary of State would keep aside any excess sterling in the Paper Currency Reserve in London so that expansion could be undertaken in India on the backing of created sterling securities. If conditions grew impossible, hundis were employed but often proved inefficient and was a cumbersome procedure for expansion and only resorted to if trade demand was acute. If it was possible the GOI preferred the liability for expansion to rest squarely on the India Office.

"We should much prefer to expand against sterling in the first instance and reverse the transfer later by creation of ad hocs (intermediary treasury bills), if this proves necessary rather than to keep unnecessary balance in London with a view to meet liabilities at the end of February, this would ensure keeping the undesirable process of expansion against ad hocs down to a minimum which is absolutely necessary." (emphasis mine)

..../contd.
compromise was evolved; foreign exchange balances could be liquidated for expanding currency requirements on the backing of reserves in London, whereas for the purpose of internal trade the Government of India would have to issue notes on 'hundies' presented to them. Currency expansion required by such hundies were to be backed by Indian reserves.

An added complication in dealing with 'hundis' was the varying rates of interest that could result in a good deal of financial embarrassment. If the Bank rate went up at a time when 'hundies' had been compounded and had to be honoured, the Imperial Bank found it more difficult to service outstanding bills at a lower rate. With frequent monetary fluctuation in the exchange ratio, bank officials were reluctant to accept hundies without careful monetary scrutiny. The unwillingness of the Imperial Bank to accept 'hundies' added to their inability

(contd.)

What the telegraphic short hand actually meant was that the Finance Department in India had requested the India Office to keep aside sterling, (accumulating in the Secretary of State's treasury from the discount of export bills presented in India) for the further expansion of currency. Efficient expansion of currency could not be carried out by ad hoc Treasury Bills because in effect this amounted to contraction at an enormous cost to the GOI.

Telegram to Secretary of State, January 5, 1929 from GOI, Fin. Dept., File No. 5(2)F/1929.

See also D.O. From H. Denning, February 21, 1929 to Finance Department, Ibid.

Also telegram to Secretary of State, March 8, 1924, GOI, Fin. Dept. File No. Acc. & Fin., April 1924, Nos.118-127, Part A.
to estimate the seasonal variation in trade and expansion was haphazard, played more by ear than by any fail-safe scientific method.¹

From 1914 onwards, the Indian currency system, because of its awkwardness and inept management was unable to function efficiently in times of crisis. Just after the war the large balance of trade accumulated on such a scale that the rupee could not expand sufficiently to absorb the increased commercial activity. As a result, government attempted to inhibit trade and often refused

¹ See, for instance, the confusion that arose when the RBI attempted to define hundis as a category of eligible assets. There was a furore because of the status assigned to certain hundis; a debate that was carried into the Directors' Board amongst which Purshotam was a notable figure. A typical comment from the Press said -

"The Reserve Bank, in defining eligible assets, as it does is, therefore, applying a rule of the thumb method without any appreciation of the conditions of India. The RBI as a lender of the last resort must learn to gauge the character of assets such as are available to the commercial banks from the point of view of their soundness. Where liquidity is not available, the suitability of the assets must be taken into consideration. It will be abnegating its role as controller of cash if the RBI pursues a policy having no relation to the Banking 'system of the country'."

S. Parthasarthy, 'Eligible Assets', Indian Finance dated October 21, 1938, p.899.
to accept 'hundis' that were rejected not only because of their doubtful validity, but because racial prejudices worked against the small trader. ¹ As the value of the rupee rose above two shillings, seasonal variations in currency requirements were inefficiently handled. Banks were asked not to do more than a certain maximum amount of business with clients and the commercial community found its credits restricted and unavailable. The post-war boom was a formidable problem that shook the foundation of the rupee; it was the beginning of what has come to be termed as the exchange debate.

The War and After

The immediate effect of the outbreak of the war was a general dislocation of trade and business. However, by about August/September of 1915, production in Indian industries, stimulated by an almost total absence of foreign competition began to pick up, and with it came signs of confidence among the commercial community.

¹. Hooseinbhoj Laljee, retiring President mentioned the Imperial Bank's attitude against the small trader. The issue was dealt with in detail in the Appendix to the 1930 Report. Report of the IMC for the year 1930, pp.358-59.
community and increased business activity.\textsuperscript{1} The balance of trade began to turn abnormally in favour of India and during 1916, 1917 and 1919 the trade surplus grew uncomfortably large.

The balance was so large that the Government of India had to, during the greater part of the war period, face an entirely new situation. In spite of the heavy and almost lavish investments in English war securities, the enormous trade payments could not all be met.\textsuperscript{2}

1. \textbf{The Babington Smith Commission Report} has summarised currency history between 1913 and 1918. See the Report Volume and the Introduction to the Commission of 1919, Para 12, 13, 14 and 15.

2. The arrangements made were as follows:

A portion of the currency reserves of India was invested in British Treasury Bills instead of being held in the shape of earmarked gold. These funds were lent to the British Government, just as an American loan was granted to the allies to cover a large portion of their disbursements in America. A part of the repayment was also written off as a war gift to the British Government to the extent of the proceeds of the war loan raised in India. Some idea of the size of these transactions may be gathered from the fact that war expenditure of His Majesty's Government, involved India in a net outlay of £128 million during the first three and a half years of the war, and in addition to this, about £30 million a year on an average had to be provided by Council drawings to meet India's internal demand of trade for fresh funds. It was estimated that India's investments in British Treasury Bills would amount to £67 million by April 1918.

\textit{Jathar & Beri - Indian Economy} p 285 Vol. 2
The gold which in the years immediately preceding the war was becoming more and more acceptable to India for settling trade balances due to her, was under war conditions impossible to obtain; belligerents and neutrals were guarding and adding to their gold reserves with jealousy. The only other alternative open to the Government of India was to coin new rupees and add to the note circulation, and when both these were used to the utmost limits of prudence or good faith, to raise the exchange value of the rupee.\(^1\) Between April 1915 and the end of 1919, nearly 120 crores of new rupees were put into circulation. Note circulation, which was about 68 crores on the 31 March 1914, rose to over 166 crores.

In spite of this enormous expansion of currency these measures were inadequate. Government had to correct monetary imbalance to prevent a paralysis of

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1. Dadiba Dalal in his minority report said:

"During the war, however, the fiduciary issue was expanded to an enormous extent without regard for the considerations which formerly decided extensions of that form of issue. It was no longer a case of investing a portion of the metallic reserves held in India against outstanding notes; notes were boldly issued against which no metallic reserves in India ever existed."

Dadiba Dalal Minority Report to the Babington Smith Committee, Para 22.
the export trade so vitally necessary for the successful prosecution of the war. Council Bills were sold in London on a very large scale by way of providing a means of remittance to pay for Indian exports. To meet these bills it became necessary to undertake an expansion of silver coin that could only be met by purchasing a proportional quantity of silver bullion on the international market. These large purchases of silver by the Government of India in order to meet the additional demand for currency in conjunction with a decrease in the world supply of silver and the increased demand from other countries, led to a rise in the price of silver. From 27½d per standard ounce in 1915, the price of silver rose to above 43d per ounce in August 1917.

1. "The GOI had to incur heavy expenditure on behalf of His Majesty's Government during the war. From 1914 to December 1919, £240 million had to be spent on military equipment in the eastern theatres of war and to meet civil expenditure in occupied territory. In addition to this, the demands of war made it necessary for financing purchases in India, on behalf of some of the Dominions and colonies, and also for the African importers of Indian produce."

and 55d in September 1917. Temporary international control agreements resulted in the price of silver being kept within the limits of 41 and 49d per ounce. But in May 1919, the United States and the United Kingdom withdrew this control, and in the same month it reached 68d per ounce, 78d per ounce by December and the highest quotation was attained in February 1920 when the London quotation rose to 89d per ounce.

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1. "In order to maintain the exchange at 1s4d, the government was compelled to sell considerable quantities of Council Bills and put larger and larger amounts of rupees into circulation. This went on until silver reached a price at which the market value exceeded its face value, and once this point had been passed the government could no longer afford to supply any further coins."

Midland Bank Review, August/September 1926, p.2.

It was at this point that the rupee was divorced from sterling.

"Sterling had broken away from gold, thus the entire character of the rupee exchange shifted to a dependence on the dollar which governed the price of precious metals. It was only after 1921 when commodity lost its earlier momentum that the rupee returned to its sterling orbit."


The logic of this attachment to the dollar was because America being the only free market for gold, the gold value of the 2s rupee was necessarily governed by the cross rate between America and London. This caused huge fluctuations as the American cross rate was very unstable during these years.

See B.E. Dadachanji, History of Indian Currency and Exchange, p.127.
Silver and the Rupee Exchange

Unable to handle the awkward situation, the government imposed restrictions on the sale of Council Bills in December 1916, with the result that there was a divergence between the market rate of exchange and the government rate. The Government of India could not go on selling rupees to the public at 1s 4d when the cost of a rupee had risen to 18d, 20d and so on with the successive rises in the price of silver. Hence the heavy purchases of silver, forced the price of the metal against the government of India making it imperative that a rise in the rate of exchange be allowed.

Commercial and industrial opinion was critical of the government's incapacity to restore monetary equilibrium. K.T. Shah, in his evidence before the Hilton Young Commission, alleged that the obvious alternative of tiding over the difficulty by raising loans in India on the credit of the British Government was not thought of, though exactly the same course was followed to steady the Anglo-American exchange from the very first year of the war. India, he admitted,

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1. Dadiba Dalal also suggested this as a remedy to correct the growing inconvertibility of the rupee, brought about by watering down note issue without sufficient metallic reserves.

"... but the better course would have been to invite the public to take up the bills (British Treasury Bills) or some other form of British securities. The public might not have cared to accept the same rate of interest as the India Office obtained on the investments, but even if it had been necessary to pay a higher rate of interest it would have been better to face this cost rather than imperil the safety of the note issue."


was never prepared to receive her favourable trade balance in any but the most primitive form of spicie settlement. Nevertheless, the authorities, while blaming India for her antiquated and unprofitable method of receiving her trade balances, did nothing to work out an alternative,\(^1\) while they went on perpetuating the vicious circle by selling Councils without limit and thereby creating a demand for silver against themselves. The commercial community felt that the raising of the rupee exchange which had become imperative by August 1917, had been brought about by the government forcing the market up against themselves.\(^2\)

There is no doubt that to some extent this was true. However, a remedy used to stabilize the Anglo-American exchange would not have worked in an economy where the convertibility of the rupee into specie was an important consideration.\(^3\) In a depressed economy

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1. Ibid., p.529.
3. It would have only postponed the eventual demand for sterling. The real problem was the growing problem of inconvertibility of the rupee that had assumed disastrous consequences for note circulation. A telegram from the Viceroy dated November 8, 1919 stated that the rate of discount on currency notes in the Central Provinces and Bengal was an unbelievable 19 per cent and 15 per cent. In Burma, it was not as high but still an alarming 13.5 per cent. Dadiba Dalal said -

"To my mind inconvertibility would be a disaster of the first magnitude for the note issue and for India. It would destroy all confidence in the government's own paper money."

where agricultural operations were serviced by a predatory class of moneylenders, savings could only be expressed in silver or gold, precious metals not as prone to depreciation, or fluctuation in value. Additionally, raising loans in India at a time when there was an unsatisfied demand for money would have been difficult if not impossible. If such loans were raised on the backing of London held currency reserves His Majesty's Government would have been more than unwilling to transfer such bullion hoards to India. To the Government of India these alternatives were not really alternatives, but imponderables that imperial and monetary priorities would not have allowed.

Changes in the rate of Exchange

<table>
<thead>
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<th>Date</th>
<th>Exchange in Sterling</th>
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<th>Exchange in Sterling</th>
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<tbody>
<tr>
<td>January 3, 1917</td>
<td>1s4d</td>
<td>August 12, 1919</td>
<td>1s10d</td>
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<tr>
<td>August 28, 1917</td>
<td>1s5d</td>
<td>Sept., 15, 1919</td>
<td>2s0d</td>
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<tr>
<td>April 12, 1918</td>
<td>1s6d</td>
<td>Nov., 22, 1919</td>
<td>2s2d</td>
</tr>
<tr>
<td>May 13, 1919</td>
<td>1s8d</td>
<td>Dec., 12, 1919</td>
<td>2s4d</td>
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The Official Remedy

As a result, in August 1917, the exchange was raised to 1s5d and shortly afterwards the Secretary of State announced his intention to base the rates of exchange on the sterling price of silver, raising them as the latter rose. Additionally, the paper currency was increased without the usual metallic backing and the government imposed additional taxes, restricting capital expenditure to raise the purchasing power of the rupee.

One of the most resented measures was the restrictions on trade finance which was tolerated by the commercial community only on account of the special requirements of the war period. The Government of India made it mandatory for banks to curtail their financial

1. Dadiba strongly objected to the raising of the exchange. He believed that even if the exports of silver were disallowed, there were other means by which positive trade balances could be liquidated without importing silver.

"Rather than give up the sale of rupee bills the authorities raised the rate of exchange, so breaking the ratio and continued to offer rupee bills for sale."

Evidently, it was in the larger imperial interest of Empire monetary union that no alternative be employed in tackling the disequilibrium caused by the rising price of silver. Council Bills and Reverse Councils were an important way by which Britain liquidated positive trade balances as an international means of payment and eventual support for sterling, and Imperial Authorities were understandably reluctant to dispense with Council Bills altogether. Hence the almost uncontrollable monetary dislocation.

See also, L.S. Pressnell, p.78, op.cit.
accommodation only to those traders with a government licence or those able to provide complete financial guarantees. The banks were bound by no law to respect such orders, except for the fear that on default they might be cut off from a share of Council Bills that would have otherwise fallen to the lot of complacent banks. Similar prohibition of certain classes of exports, though restricting trade in those articles, did not affect the enormous balances of trade and was not a success in limiting the rise in exchange. The only remedy that had some effect was the Gold Import Act.\(^1\) The forcible

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1. The Gold Import Act was an unpopular measure. The complaint against government was that they dictated money policy with scant regard for the Indian people and the commercial community. Bombay Chronicle reporting on a public meeting, said of the Gold Import Act:

"Where the recommendations are not suited to the fancy of the gentlemen who dictate policy, they reject them. Take, for instance, the need for abolishing the embargo on the import of precious metals in the country. All the members of the Committee unanimously recommended it, but Mr. Hailey has taken a retrospective appreciation as a mandate for the future in spite of the definite opinion of the Committee (Babington Smith) to the contrary."

Bombay Chronicle report on the public meeting held on March 20, 1920, under the auspices of the IMC. Saturday, March 27, 1920, Bombay Chronicle.

See also, a memorandum on behalf of the BMOA, whose President, Ibrahim Rahimtoolah passed a resolution on the Gold Import Act, condemning it. Bombay Chronicle, April 16, 1920.

See also, Finance Department GOI, regarding 'resolution passed at a meeting of Bombay Citizens held on March 20, 1920 to protest against currency and exchange policy of the GOI, File No. Acc. etc. Aug. 2237-2247/20, Part C, NAI.
acquisition by the government of all imports of treasure on private account, coupled later on with restrictions on the export of rupees or silver bullion from India, came perhaps a little too late and prevented very little of the confusion and panic of the first few post-war years. The rupee was out of control and some solution had to be found to tame the financial upheaval.

The Currency Committee 1919

The Babington Smith Committee appointed in 1919 to consider the whole question and to advise upon it, indicated the gravity of the situation; currency instability was clearly detrimental to the working of the government. The Committee recommended that the price of silver would continue to be high and that if the exchange value of the rupee was fixed at a figure not lower than 2s gold, convertibility and the maintenance of a satisfactory monetary circulation would be assured.

1. The object of the Gold Import Act was to prevent speculative purchases of precious metals; and by centralising their supply in the hands of the government to provide an abundant supply as far as demand was genuine trade demand. Unfortunately, the measures were adopted at a time when the crisis had already become acute. As a result, the government order merely encouraged smuggling and considerable quantities found their way into India through Madras. See H.L. Chabani, Indian Currency and Exchange, pp.77-86.

## General Prices - Yearly Average

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<tr>
<th>Year</th>
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<th>Weighted Index Number</th>
</tr>
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<td>1918</td>
<td>211</td>
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</tr>
</tbody>
</table>

Even as early as 1919 the two shilling rupee was uncomfortably perched. A number of spokesmen, K.T. Shah among them, believed that it was official profit that led the Babington Smith Commission to

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prefer a high exchange ratio.¹ A low rate would mean high prices which would entail great hardship on the poorer classes and on those with fixed incomes and would promote great unrest and discontent much to the embarrassment of the Government of India already troubled with political disturbances all over the country. K.T. Shah countered the limited advantage that a high exchange would allow by arguing that the cultivator, who would ordinarily be the first to profit by the high prices of produce, whether foodgrains or other raw materials such as jute and cotton,

1. One of the more prominent reasons for fixing the exchange value of the rupee at 2s was to lessen India's demand for gold.

"The fear is thought to exist that under free conditions India's absorption of gold would diminish the chances open to other countries of obtaining gold to restore the value of their insufficiently backed paper issues. The amount of gold going into India would depend upon the extent to which silver purchases of the Indian Government displaced private imports of gold as a means of balancing Indian Trade; a higher price limit would secure a larger supply of silver, thus diminishing the gold taken by India. It follows that the fear of undue gold absorption would be pro-tanto met by the proposal to fix a high rate of exchange, which is recommended... below as a protection of Indian masses from the effects of high world prices arising out of the war. The volume of currency would still be automatic but the limits of the government control over the proportion of its constituent elements as between silver and gold would be extended, pro-tanto, by fixing a higher rather than lower limit to the government's buying price of silver."

The crucial point here is that by raising exchange, the buying of silver was still attractive, because of its greater relative cheapness to the Indian buyer than gold, whose internal price remained undisturbed, at a time when the price of silver on the international market was fast appreciating.

would see his profits disappear with falling prices.¹

The exchange debate had clearly begun, and with every salvo, the controversy grew more complicated and less easy to untangle.

¹. This was a favourite argument and one that was often repeated. One such petition went into an arithmetical analysis of the effect on the Indian cotton grower.

"Generally, in normal times, Indian cotton is sold on the continent at an average of about one penny below American cotton. Suppose 100 bales each of 400 lbs of cotton are sold at 8d per lb on the continent they will realise 320,000 pence. Converting them at 18p/rupee will give us Rs.17,777. If the ratio was 16p/rupee, Rs.20,000 would come to hand. The loss of Rs.2,222-1/3 per 100 bales goes direct to the cotton grower. India produces on an average 6,000,000 bales of cotton, so the total yearly loss to the cotton grower comes to more than Rs.13 crores. The loss will be greater if the prices are higher."

Using the same method for jute cultivation, and the wheat and rice producer, the writer calculated the annual loss to agricultural interest alone to be in the order of Rs.50 crores. A very convincing argument which, to some extent, is true; the loss was realised as an enormous advantage in the transfer of sterling remittance to the Secretary of State. However, it is not highly recommended to accept this argument at face value.

Hansraj Harji, Letter to the Editor, The Times of India, August 25, 1926.

See also, Letter to the Editor, Bombay Chronicle, August 16, 1926, from 'Perverse'.

See also, Rattan Thacer about the new ratio as a 7½ crore loss to the cotton grower. Bombay Chronicle, August 10, 1926.

Why I have called this debate irreconcilable is because though the mathematical argument sounds convincing the debate, because of a lack of qualifying data, can be endless. The Statesman, replied saying:

"That they (the agriculturist) would do so (obtain better prices for exported produce) is plain enough, but would the greater number of rupees buy more. As rupee prices would be raised all around the agriculturist would be no better off and the 21 per cent of the population would be decidedly worse off until wages had been adjusted to prices."

The Smith Committee agreed that there would be some dislocation of trade and commerce. A rise in the rate would stimulate imports and discourage exports, however, these effects were transitory in character and would disappear when wages and other elements of cost had adjusted themselves to the new rate of exchange. The Smith Committee also believed that the export trade was likely to suffer even less than was feared, because the demand for India's goods abroad was very keen owing to the world shortage of raw materials and foodstuffs. Besides, if continuous demand for Indian goods persisted, the high rate of exchange and the general cheapening of imports would bring substantial advantages to the Indian producer.¹

¹ "We are told that what the cultivator loses as a producer he will gain as consumer by the cheaper cost of imported goods. I have been at some pain to look into and analyse the trade figures for the past year and I find that while exports totalled 309 crores, the imports totalled only 208 crores, of which only some 12 crores can at most be considered to be goods more or less consumed by producing classes so that while they lose on 309 crores of exports they benefit only on some 12 crores of imports."

Rattan Tata, in the Imperial Legislative Council on the occasion of the Bill to amend the Coinage Act, August 31, 1920.
Of course, government finances would stand to gain enormously from the high level of exchange and the annual saving in respect of the sterling obligations would amount to ₹12.5 crores, if the old ratio of 1s4d was abandoned in favour of the new one of the 2s gold. Though there would be a loss involved in the revaluation in terms of rupees of the sterling investments and of the gold in London, at the new ratio the whole of this loss would be wiped out in the course of three years by the savings effected in connection with the home charges. And after this had been done, a considerable surplus revenue would remain and be available for employment in further economic development of the country or in reducing taxation. At least so the Committee claimed.

Sir Dadiba Dalal, a member of the Committee and a business spokesman, opposed the stabilisation of the rate at 2s gold.¹ The recommended high exchange took

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¹ The exact wording of the recommendation was as follows:

"The stable relation to be established between the rupee and gold should be at the rate of ₹10 to one sovereign or in other words at the rate of one rupee for 11.30016 grains of fine gold both for foreign exchange and internal circulation."


This was legislated under the Indian Paper Currency Act 1923, and corresponded to the rate of exchange of 2s per rupee. This was altered by Section 2 of the Currency Act, 1927 to 8.47512 grains of gold per rupee, that is the amount of gold corresponding to an exchange rate of 1s6d.

Om Prakash Gupta, Central Banking in India, 1773-1934, p.116.
no account of the changed circumstances after the war.\textsuperscript{1} The Babington Smith Committee had come to the conclusion that the price of silver had been raised by the falling world production side by side with the great increase in demand for silver. The fall in


"The Committee also admitted that it was extremely difficult to foresee future developments and if a great and rapid fall in world prices over to take place it would be necessary to consider the problem afresh."

In other words, the Smith Committee recognised the heavy fall in prices as a possibility (which indeed all history preshadowed); but nevertheless simply because they were asked to make recommendations to ensure a stable gold exchange standard they made proposals based on a contrary assumption.

The Times of India

"But it (Babington Smith Committee) was warned by the dissenting members, Mr. Dadiba Dalal, that the Indian export trade could not stand the rate of exchange which it favoured; the Finance Committee of the India Office ought to have recognised the disturbance by the fall in the American cross rate.

The Times of India, leading article on currency and finance, June 22, 1920. See also, The Times of India, leading article, July 1, 1920, again on August 10, 1920, which recorded an emphatic protest against the proposal to amend the Indian Coinage Act and the Paper Currency Act to suit the 2s ratio."
production, they believed, was temporary, due to war conditions of the high price of accessories for mining as well as owing to unsettled political conditions in Mexico. After the war, the Smith Committee felt production would be increased and the demand would remain as great as ever. Representations from the commercial community elaborated by Dadiba Dalal's own minority report said that there was a very great chance that with the end of the war, there would be a fall in demand for silver for coinage purposes by European nations on their finding even silver too costly and wasteful medium of exchange for purposes of currency. Under the circumstances, the Committee's findings on the matter were open to the most serious doubts.

Further, spokesmen of the commercial community argued against the conclusions arrived at by the majority of the Babington Smith Committee as to the effects of a high exchange on the trade and industry of India. Shah produced figures to show unmistakably that while the price of articles imported had risen between 1910-18 by 265 per cent, those of exported articles rose only by 157 per cent. Indian produce

was not fetching the same price as foreign produce and had to be paid for in terms of Indian produce. The important consideration, the commercial community claimed, was that the poor country farmer who had no means of protecting himself with hedging facilities, was forced to sell his crops in advance to the village moneylender from whom he could expect little profit if prices were kept down by official interference and trade regulation. Dadiba Dalal said:

"... and it should be remembered that between one and two hundred million people live on the brink of starvation, and a great permanent change in the rate of exchange must ultimately bring intense distress to millions of these helpless masses."  

1. Bombay commercial community was particularly outspoken in regard to imports of produce into India. "By altering the external ratio of the legal standards for money payments, India is made a dumping ground for Manchester goods at rising sterling prices. The time has come for every member of the Indian Legislative Council to challenge the right of the officials to change the external or internal ratio of the sovereign to the rupee by executive orders." S.R. Bomanji, The Times of India, in a leading article, April 15, 1920.  


3. A number of spokesmen voiced a similar concern. R.D. Tata said in the Legislative Council:

"Has government reflected on the effect of the change of ratio on the income of the vast mass of agricultural population of India, a population extremely poor and deeply submerged in debt." Consideration of the Bill to amend the Coinage Act, Legislative Council Proceedings, August 31, 1920.
The artillery of the business spokesmen was emotionally charged and always articulated as the general interest of the country. If the rhetoric was to have any effect at least the mention of poverty had an appeal that was undeniable. A witness before the Smith Committee added that the auxiliary consideration, the savings of home charges, would only be important if the Indian people had control over their finances and were able to employ the funds saved by this means in the remission of taxation for employment in industry.¹

But the character of the debate was changing. With the rupee dropping rapidly past its post-war peak, criticism of the 2s ratio was growing stronger as monetary imbalances and exchange chaos grew more difficult to control. The 2s rupee was increasingly impossible to defend convincingly.

Slump and the Weakening Rupee

During the years 1919 to 1921, there was at first a boom and then an extensive fall of prices in the United Kingdom, the United States and many other

¹. BMOA evidence to the Hilton-Young Commission. The same sentiment was repeatedly expressed in BMOA's own annual volumes.

Report of the BMOA for the year 1933, President's Speech, pp. 4-5.
countries but not in India. There is a striking contrast between the column relating to India and those dealing with the other countries in the following tables:

Comparative Statement of Indian Prices 1919-1921

<table>
<thead>
<tr>
<th>Year</th>
<th>India (Bombay)</th>
<th>U.K. (Statistics Deptt.)</th>
<th>U.S.A. (Bureau of Labour)</th>
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<td>Dec.1921</td>
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<td>140</td>
<td>269</td>
<td>175</td>
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</table>

During the boom of 1919-20, when world prices were soaring, government allowed exchange to absorb the shock with the result that the Bombay index number rose only 8 points, whereas in England there was a rise of 71 points in the price level, in U.S.A. 41 points, in Norway 103, and in France 232 points. With the falling prices, the Government of India soon found it difficult and increasingly impossible to hold the exchange rate. The price of silver

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responsibility for maintaining the rupee at the newly chosen level had to sell Reverse Councils in large amounts to satisfy the unprecedented demand that arose for remittance.¹

War time profits made by certain sections of the commercial community, resulted in a boom of company flotations and this meant orders on an unusually large scale for foreign plant and machinery of which the cost was remitted in advance in order to make the best of the high rate of exchange so long as it lasted. Eleven million pounds sold during February 1920² by the

1. S.R. Bomanji at a public meeting at the Excelsior Theatre, Bombay, on behalf of IMC, March 20, 1920.

"They have paralysed trade of all kinds and they have caused a waste of accumulated reserves in the sale of reverse bills. The reserves, I speak of, have been accumulated at the rate of ₹.15 to the pound and are being dissipated at the rate of ₹.7-8 to the pound. This operation involves India in a loss of 1½ crores of rupees per week."


By September 1920, the figure had risen to £55 million sterling.

Government was insufficient to meet the public demand; speculation and profiteering came into the field and a wide divergence arose between the gold rate at which Reverse Councils were being sold and the actual market rate.¹ The divergence at times amounted to as much as 3d to 4d and this further stimulated the demand for Reverse Councils. The downward pressure on exchange was enormous.

1. The government then issued a communique which created a great deal more confusion and resentment. As a remedy to the immense demand for remittance, government allowed the use of sterling securities in the Paper Currency Reserve to be liquidated to facilitate further remittance. What the Bombay industrial and commercial community resented was the stipulation that (I quote from the official communique itself):

"In the case of all future sales, therefore, government reserve the right to refuse any tender absolutely without assigning reasons and this right will be freely exercised in all cases in which there is a reason to question the status of the tenderer, as a bona fide remitter."

B.F. Madon accused the government of blatant racial prejudice that acted not to stop speculation but to help Europeans reap the huge profits on Reverse Bills.


See also, Bombay Chamber of Commerce, telegram to Government, February 23, 1920.


By far the most important cause, however, for the sagging down of the exchange was the tendency towards an adverse balance of trade. During the 12 months from March 1920 to March 1921, the balance of trade that had been largely in favour of India rapidly diminished and a growing negative balance asserted itself with every passing month. Government started selling Reverse Councils at rupee rates based on 2s8d sterling, but by the end of June 1920, the market rates for exchange fell below the parity of 2s sterling and by March 1921, the exchange rate was down to 1s4d.¹

It was in times of crisis that the awkwardness of the monetary structure made government policy clumsy and ineffective. To maintain the rupee at 2s gold or even 2s sterling, government sold Reverse Councils to the extent of £55,532,000 in 1919-20 and 1920-21, meeting them at first from the Secretary of State's treasury balances in India.² Between March and October 1920, the Secretary of

¹. Hilton-Young Commission has as good a summary of currency history between 1919-25 as the Babington Smith had on the earlier period. See respective Reports Babington Smith Committee, pp.6-20, Hilton-Young Commission, pp.1-9.

State drew £46,650,000 from the Paper Currency Reserve in England, which should have involved a contraction of currency in India to the extent of ₹.68.73 lakhs. But afraid of creating monetary stringency by contracting currency to this extent, government issued ad hoc treasury bills to the extent of only ₹.34.05 lakhs. The net result of these transactions was, therefore, that the currency was contracted by ₹.34.68 lakhs as against the sale of Reverse Councils amounting to £55.5 million from which government realised ₹.47.14 lakhs in India.

1. See correspondence between Secretary of State and Finance Department on the sale of Reverse Councils, the movements of securities in and out of the Paper Currency and gold standard reserve. The T.B.'s outstanding in March 1920 and 1921 and the ways and means expenditure of the government in 1920.

GOI, Fin. Dept., File No. Acc.& Fin., January 1921, Nos. 6-104, Part 'A', 'Sale of Reverse Councils in London'.

2. The position at the beginning of 1921 was much worse. In addition to Reverse Councils sold to the extent of £55.5 million, several additional millions had been sold through the Post Office and the government had incurred a loss of not less than 35 to 40 crores of rupees. Additional losses were borne on the sale of gold at cheap rates in an attempt to depress the local market for gold and thereby prepare the way for the new ratio of ₹.10 to the sovereign. No official figures of such losses are available.
Despite government's attempt to blunt the effect of these measures on the commercial community, it became increasingly impossible to generate any permanent advantage, through marginal monetary concessions.\(^1\) Any courageous policy of deflation was out of the question so long as government budgeted for deficits to live on credits, had a host of Treasury Bills maturing constantly, and were anxious to avoid unpopularity with the commercial classes who disliked nothing as much as a stringency in the money market.\(^2\)

\(^1\) BM OA claimed that high exchange had unfortunate side effects on money conditions. Ibrahim Rahimatulla, President of BM OA, contended on behalf of the Association that:

"Owing to the stringency in the money market consequent on the sale of Reverse Councils there is capital being withdrawn from the country and the export and import trade of the country is being paralysed."

As reported in Bombay Chronicle, April 29, 1920.

\(^2\) Stringency in the money market as well as the government's deficit budgeting and its early inability to balance budgets was exhaustively discussed by the Indian Retrenchment Committee 1922-23. Sir Purshotamdas Thakurdas has, in his collection of private papers, his own views presented before the Committee. His report is interesting because of the statistics he provides on currency contraction etc. See also, Report of the Indian Retrenchment Committee (1923).
The budgetary problems of the Government of India in 1920-21 were probably unique. Priorities of the war and the imperial order had increased the Government of India borrowings both for defraying the expenditure of the Indian Army in India and abroad by a further £45 million in the last month of the war. Further, during the war, the Government of India invested heavily in sterling securities as a measure to stabilise the rate of exchange at £1.4d and with an increase in interest rates and the rise in the Indian rate of exchange.

1. The Times of India reported that the concern over run-away spending of the Government of India was shared by both Indian and English businessmen. Lord Inchcape, a leading figure in the Geddes Committee, on retrenchment of government spending and recently nominated to the Indian Retrenchment Committee warned the GOI in a speech to London businessmen that:

"They (GOI) were slithering down an inclined plane of prodigality and indebtedness, which would land the country, unless they acted promptly and resolutely in a series of budget deficits."

This was in response to a budget announcement of Sir Malcolm-Hailey who said in the Legislative Assembly:

"Including the deficit of the current year during the past four years, our expenditure... debitable to revenue... has exceeded our revenue by a total amount of 90 crores... we have been living on credit".

The Times of India, April 27, 1922, Article entitled 'The Slippery Slope'.

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during the years 1918-20 the government sustained heavy losses. Coupled to the Reverse Council fiasco, the post-war period was marked by largely increased expenditure on current account while revenues which were inelastic had not expanded correspondingly.

The revenue position made the working of the government that much more difficult and it became impossible to undertake any substantial administrative expenditure if the rupee had to be maintained at two shillings.\(^1\) Hence deflation had to be undertaken to satisfy remittance but could not be pushed too energetically what with deficit budgets, falling exports and uncomfortable criticism from indigenous entrepreneurs. These contradictory impulses were not uncommon in the history of Indian financial policy between the two wars; indeed it illustrated

\(^1\) This object was achieved by allowing the tender of gold at currency offices and the gold imported as a payment to settle favourable balances of trade to be absorbed into hoards. The metal did not contribute to an expansion of currency and as a result money stringency developed. The rate was manipulated by:

"The normal average pre-war expansion of currency was 20 crores of rupees per annum. During the last four years the normal expansion should have been 80 crores, instead of which only 43½ crores of rupees further was allowed to the country. The result of this policy was the catastrophic depression in trade so well known to everybody".

the enormous problem of manipulating exchange, yet searching for some degree of monetary equilibrium amidst deliberately disturbed money conditions. There was no suitable compromise that could balance the priorities of the imperial system against the growing influence of the native commercial community. Remittances had to be maintained, investments in British securities had to carry on, the currency systems could not be made automatic, yet Indian commercial opinion could not be ignored.

During the 1920-21 crisis, there was a sizeable portion of the commercial community who suffered heavy unrecoverable losses owing to the failure of the government to maintain the high exchange rate; goods for the expansion of industry, that had been ordered during the post-war boom, under the confident expectation that exchange would remain high suddenly went up in value.¹ This was the last straw. It meant nothing less than bankruptcy to many importers whose reliance on the government's ability to keep the exchange at the desired

level was so complete that they failed to take the usual precaution of covering fluctuations in exchange.¹

Not that this disturbed the economy at large nor did it encourage a general social dissatisfaction with government. It was a limited group of industrialists and commercial businessmen who complained,² but the discontent had enough bite to force the government to reconsider the rupee. Traders, export merchants, industrialists, commercial men were all in a position to influence the purchase and sale of sterling, which was a confrontation that government was anxious to avoid as they could not allow the machinery of remittance to collapse. Hence, after the failure of the attempt to stabilise exchange,

1. "The docks at Calcutta, Bombay and other places were full of goods which the merchants could not take over and which had been ordered on the basis of two shillings in the rupee. When the goods arrived in India, exchange came back to 1s6d in the rupee. This loss to the Indian merchants and traders was due entirely to the policy of government."

Extract from a resolution on the currency question by S.R. Bomanji at the National Congress at Nagpur on January 1, 1921. In moving his resolution, Bomanji made a powerful speech and was seconded by C.R. Das and Navandas Purshotam of Bombay. A brief report of the proceedings was published in Times of India, January 3, 1921.

2. "... a policy that was avowedly adopted to secure a fixity of exchange produced the greatest fluctuations in exchange of a solvent country and widespread disturbances of trade, heavy losses to the government and brought hundreds of big traders to the verge of bankruptcy."

government untied the rupee, and took to watching the free rupee and nursing it as international trade slipped into depression.¹

Upwards to the ls6d

In 1922-23, the export trade of India showed a revival owing to good harvests and an improvement in the purchasing power of the European countries. The joint result of the contraction of currency and the revival of exports was to raise the exchange value of the rupee slowly but steadily. In September 1923, the rupee was equivalent to ls3d gold and the pre-war ratio of ls4d could have been easily restored without adversely effecting the economy of the country, as was unsuccessfully urged by the Indian Merchants Chamber.² The government, however, was apparently trying to take the ratio up to

1. In the year 1921, the balance of trade was still against India. The depressed condition of the export trade was due to a rapid fall of world prices in terms of gold and the still more rapid fall of sterling prices owing to the steps taken by England to bring sterling back to gold parity. Government's attempt to deflate the currency was unsuccessful and pushed exchange down to ls3d at which point the Secretary of State discontinued the sale of Council Drafts and Reverse Councils.

2. As was unsuccessfully urged by not only the IMC but by EMOA, AMOA, BCC, an extract from the Vice-President's speech to the annual General Meeting would serve as an example of the strident criticism of the IMC. See IMC Annual Report for the year 1935, pp.6-7.
ls8d, and the rupee reached the level of ls6d in October 1924.\(^1\) The government's action after this was directed towards preventing the rise of the rupee much beyond this point. In order to achieve this result the purchases of sterling required for government remittances, and when necessary, in excess of this requirement were freely used, and fresh currency was issued against these purchases, thus incidentally relieving to some extent the monetary stringency occasioned by the government's earlier policy of deflation.\(^2\) The exchange value of rupee reached ls6d gold in April 1925 and remained or, as the critics of government would have liked to put it, was held there since.

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1. Even the *Midland Bank Review* admitted that this was a result of deflation.

"... consequently, the exchange value of the rupee fell headlong. A rate below ls3d, say ls gold was reached early in 1921. Thereafter by a process of steady deflation the rupee rose in terms of sterling. The later became synonymous with gold at the end of April 1925, but already the rupee had reached ls6d, a level which has been approximately maintained ever since."

*Midland Bank Review, August/September 1926.*

2. The *Pioneer* defended this action of government claiming that it was not 'manipulation' but rational monetary remedies to maintain the only true rate i.e., the 18d rupee.

"If government had not intervened in October 1925 by making extensive purchases of sterling the rate would have gone far above ls6d. World conditions themselves altered the rate of ls4d as early as 1917 and what is now sought to be done is to give legislative sanction to a current rate instead of to a rate which was left more than eight years ago."

*The Pioneer, August 15, 1926, 'The Eighteen Penny Rupee'."
The anxiety of the government to maintain a relatively high ratio of exchange became increasingly apparent towards the middle of 1925.\(^1\) In spite of the increased pace of international trade prices in India were held steady. Blackett explained that due to rising external prices a higher exchange ratio would prevent inflationary trends from influencing Indian prices.\(^2\) The Finance Member was not entirely incorrect. From January 1922 to March 1923, prices rose continuously in the United States, the index number being 138 in the beginning and 159 at the end of the period, while the 'Economist' index number of Great Britain rose only 4 points from 159 in January 1922 to 163 in March 1923. During the same

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1. Sir Basil Blackett, Evidence to Hilton-Young Commission, Appendix, pp.65-71, Policy 5-7, as listed in India, Paras 9981-10545.

The Finance Member, Sir Basil Blackett, in his budget speech of 1925, forwarded a number of considerations that he believed had to be kept in mind in the discussion of the exchange question:

a) The sterling obligations of government and private individuals.

b) The relative importance of stability of exchange and stability of internal prices.

c) Monetary stringency and inflation that may be necessitated by the adoption of a particular ratio.

d) The effect of exports and imports and in the interests of those associated with them.


period, the Calcutta index number rose from 175 in January to 182 in May, fell to 172 in December 1922, but rose again to 177 in March 1923. From December 1923 to September 1924 the gold prices in the U.S. fell only 2 points while the Calcutta index number stood at 174 in December 1923 and at 175 in September 1924.¹ Indian prices, as Blackett reported, stood relatively steady during the period between January 1922, when the exchange stood at 1s4d and September 1924 when the exchange had jumped to 1s5d and beyond. The Calcutta index number being 175 in January 1922 and 174 in September 1924, during the same period, the U.S. index number rose from 138 and 141 in January and February 1922 to 150 and 149 in August and September 1924, while the 'Economist' index number for Great Britain registered a rise from 159 and 158 in January and February 1922 to 172 and 176 in August and September 1924.² The monsoons during the interval were exceptionally

¹. Index Prices as reported by B.P. Adarkar, The Indian Monetary Policy, p.47. United Kingdom Index Numbers from Economist (1913), United States from the U.S. Bureau of Labour (1913 base year) the differing base years would have an inbuilt bias of about 4.34 per cent. See also, the wholesale price index for India reproduced in H.L. Chablani, Indian Currency and Exchange, p.141, which reproduces the official statistical data published by the Statistical Abstract on Prices, Monthly/Annually every year.

². Ibid.
good and the normal expansion of trade would have tended to produce a marked fall in the Indian price level, but for the fact that government expanded the currency by 3 crores in 1922-23 and 22.5 crores in 1923-24 to prevent any further rise in exchange from 1s6½d. What indeed camouflaged the official constraint on the rupee, was expanding international trade which for the time being at least eased the problem of remittance. Deflation did not have to be pursued as long as large trade surpluses were piling up in India's favour.

The official concern over the rupee was as suffocating as always. At the time the government claimed that 'it was preventing inflationary trends from influencing Indian prices', there was a close sympathy between the movements of Indian prices and the changes

1. However, the Midland Bank Review had to admit that:

"According to the official index number of wholesale prices in Calcutta, the average for the whole of 1925 was the same as the average of the 'Statist' numbers for Great Britain taking July 1914 as the basis for both cases. This would suggest that if 1s4d represented the Anglo-Indian price equilibrium in 1914, it should do so at the present time. But the figures for India were so important that any specious correspondence they present must be set aside in view of the recent Commission's considered opinion...."  

Midland Bank Review, August/September 1926, p.2.
in the volume of circulation (1920-24). The following table will be useful:¹

**Comparative Statement of Prices and Money Supply, 1914-1924.**
( Crores of Rupees )

<table>
<thead>
<tr>
<th>Year</th>
<th>Rupees in active note circulation</th>
<th>Average active Bank deposits</th>
<th>Total circulation</th>
<th>Index of total circulation</th>
<th>Calcutta index No.</th>
<th>Bombay index No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1914</td>
<td>187</td>
<td>45.43</td>
<td>94.00</td>
<td>326.43</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>1920</td>
<td>260</td>
<td>138.88</td>
<td>235.00</td>
<td>633.83</td>
<td>194.0</td>
<td>204</td>
</tr>
<tr>
<td>1921</td>
<td>233</td>
<td>152.22</td>
<td>224.22</td>
<td>609.89</td>
<td>186.6</td>
<td>181</td>
</tr>
<tr>
<td>1922</td>
<td>247</td>
<td>153.27</td>
<td>206.18</td>
<td>606.18</td>
<td>185.6</td>
<td>180</td>
</tr>
<tr>
<td>1923</td>
<td>244</td>
<td>156.93</td>
<td>195.63</td>
<td>596.56</td>
<td>182.7</td>
<td>176</td>
</tr>
<tr>
<td>1924</td>
<td>234</td>
<td>160.91</td>
<td>207.36</td>
<td>602.27</td>
<td>184.4</td>
<td>177</td>
</tr>
</tbody>
</table>

After 1924, the government encouraged a strong exchange by deliberately restricting an expansion of

¹ For table, See H.L. Chablani. Presumed source is the Dept. of Statistics for British India. See also, differing estimates over rupees in circulation. Hilton-Young Commission Report and Evidence Volumes.

B.F. Madon: No definite estimate possible, Para 3594.
Khaitan: 'Estimate', Para 8098.
Banthiya: Para 8533/6.
Nalini Ranjan Sarkar: Para 9148/51.
Basil Blackett: Approx. estimate, Appendix Vol., pp.66.

See, H.L. Chablani p205 op. cit. see also Banking and Monetary Statistics, sec. 7 p650-663
currency. Between September 1924 and June 1925, the Calcutta index number fell from 175 to 153 in spite of an addition of 16 crores to the total volume of currency owing to the abnormally large increase in the volume of Indian trade. During this period, the 'Economist' index number fell from 176 to 162, while the United States index number rose from 149 to 157. The fall in Indian prices in this period was very much greater than in England and was in no way justified by the movement of world prices, as reflected by the United States index number. Hence the 1s6d rupee even during a time of expanding trade was the consequence of an insufficient overall expansion of currency. It was at this juncture that the government armed with the argument that it had undertaken no contraction now sought to promote the hallowed 1s6d rupee as the 'natural rate'.

The precarious revenue position of government was probably the most important reason for the higher ratio. 1923-24 were years in which the government was besieged by a growing public concern over its increased spending. The total deficits from 1917-18 to 1922-23 amounted to more than ₹980 million, and since these years were also marked by a considerable uncertainty in
exchange rates, private business regarded the increased government borrowings with great misgiving. Faced with imperial priorities that demanded continual remittance, and the government's uncomfortable financial position it was important to gain as much advantage as was possible from exchange.

The case for a higher ratio was almost given away when Basil Blackett asserted that it was owing to the saving government made on its remittances at the higher

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1. The Retrenchment Committee was welcomed by both London as well as by Indian businessmen who for among the few times joined hands in petitioning the government for reduced spending. The reasons were:

"The long balance of trade against India has reduced the supply of loanable capital. The high prices paid for money by government had raised the price of money against the industrialist and the businessman. The heavy demands of government on the limited quantity of capital available in India have forced industrialists to pay excessive prices, where they have been able to get money at any price."

"If the limited supply of capital is depleted by an excessive income tax, if it is drawn upon for unremunerative expenditure, the balance remaining for productive expenditure is reduced and the price of money goes up, whilst interest charges increase without any increase in revenue. If deficits are met by watering the currency, up go prices, up goes the cost of the administration, down goes exchange, and in the last case the government is worse off than the first."

The businessmen's plea for a reflation to a lower ratio was also influenced by their desire for financial equilibrium.

The Times of India, April 27, 1922.
ratio that there were surpluses in the budgets and that but for this, additional taxation would have been inevitable and the remission of provincial contributions would have become impossible.\footnote{1} This was tantamount to the admission that the gain of the public exchequer was purchased at a very heavy cost borne by the mass of the

1. As far as the stability of the rupee at 1s6d was concerned, there was considerable benefit to the government in terms of revenue saved, when the lower ratio would have meant increased expenditure. The Statesman reported that:

"To fix the rupee at 1s4d would in one stroke add 12.5 per cent to all home charges that the GOI has to make. For interest on debt held abroad that would mean an addition of over two crores a year."

Nor did the Statesman think that that was the end of the story. The Indian Government purchase of stores, provincial government's foreign purchases would all add up to an enormous extra burden on the revenue position of the government. As a result, the government would have to raise fresh taxation, the Meaton award contributions would have to resume the excise duty on cotton would have to be reimposed all of which believed the Statesman, the Bombay business did not realise, and would not welcome. The Statesman, August 11, 1926, Article entitled 'The Extra Two Pence'.

Also, The Capital reported that:

"... the shock (from a reversion to 1s4d) to budget equilibrium and, therefore, public credit constitutes objections to such a step too formidable to ignore."

The Capital, August 15, 1926.
population;¹ and it was not demonstrated beyond dispute, said many a critic, that such a sacrifice claimed from the large producing classes and the industries of the country was in the paramount interests of the nation.²

The government was nevertheless growing more and more convinced that it could fix the rupee at 1s6d and as long as international trade remained healthy, government could quite justifiably claim that manipulation was at a minimum.


2. Those like K.T. Shah were severe critics. They not only charged government, they also alleged that the Bombay businessmen for being transparently and unfairly sectarian in their approach to the exchange problem. K.T. Shah, in fact, accused the Bombay businessmen and Purshotamdas in particular of having deliberately ignored the most important feature of the entire debate. It was not the difference between a 1s6d or a 1s4d rupee that was relevant, but the establishment of a gold bullion standard that would automatically adjust the difference between rupee and sterling.

"To those who have been convinced advocates of a simple, straightforward automatic gold standard, the question of the rupee ratio to gold is merely of passing importance."

The People, October 3, 1926, pp.283-86, K.T. Shah, Article entitled 'The Rupee in Gold'.

Shah went on to say that the argument over exports vs. imports, financial equilibrium, increased tax burdens were all a red herring that subtracted from the real issues of developing a home market, curtailing enormous expenses on the Indian Army, reducing home charges and so on.

Ibid., p.286, See also, The Indian Daily Mail, September 20, 1926, Article entitled 'Fixing the Rupee at a Higher Price'.

¹ See, the Hilton-Young Commission. IMC in the Evidence Volume II, pp.196-97. See also, the statement of evidence by Professor Gyan Chand, pp.114-15.

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The Royal Commission

Having convinced themselves that they would only allow a relatively over-valued rupee, the Government of India could with greater confidence accede to the repeated requests from various quarters, and it promised an enquiry into the currency situation early in 1925. On August 25, 1925, a Royal Commission on Indian Currency was appointed under the Chairmanship of Lt Cdr Hilton Young. The report of the Commission related to two principal issues.

A. The selection of a standard of currency. B. The Ratio.

1. The Currency Commission specifically stated in its Report that the Currency system that the Commission had recommended was a 'gold bullion standard'. In the Report Volume it was stated that:

"We propose that an obligation should be imposed by Statute on the currency authority to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee but in quantities not less than 400 ounces. The fulfilment of this obligation will secure the stability of exchange within the gold points corresponding to the selected parity. Gold is thus made the standard of value. The rupee is linked to gold and not to sterling or any other currency or group of currencies."

This was more eyewash than anything else. P.A. Wadia, Brij Narain and K.T. Shah wrote in The People that the Commission's use of the term 'gold bullion standard' was incorrect and what they had actually recommended fell far short of any such claim. P.A. Wadia described the Commission's claim in very colourful language:

"But a gold standard means that your unit of value is a gold coin, and so long as the silver rupee remains the unit of reckoning, and full legal tender, and is to be convertible into gold bars for export, you may speak with the tongues of men and angels and yet your voice will be but as sounding brass and a tinkling cymbal."

The Currency Standard.

In spite of repeated demands for the automatic working of exchange through a gold exchange system, the Commission rejected the suggestion on the plea that a gold exchange standard would not secure the automatic expansion and contraction of currency.¹ The only

¹ There was some confusion over this. H.L. Chablani, Prof. Brij Narain and Prof. V.G. Kale participated in a running debate in the columns of The People over whether a gold exchange standard was as automatic as a gold bullion standard and what were the relative merits of both. Fundamentally, the Gold Exchange Standard suggested originally by David Ricardo did not allow notes and rupees to be freely converted into Gold Bullion or gold coin. The exchange of gold merely adjusted international payments in terms of an import or export of gold. Under the Gold Bullion System both note and gold were freely convertible. This had an important consequence: In the Gold Exchange Standard the rate of exchange varied the deficiency or redundancy of currency. In a Bullion Standard it was the purchasing power of gold that varied the purchasing power of the unit of currency. The Royal Commission opted for obvious reasons of imperial monetary unity, the Gold Exchange Standard, with the modification that instead of gold sterling was to determine the abundance or scarcity of the rupee. For the debate, see:

Prof. H.L. Chablani's Article in The People, August 22, 1926.
Prof. Brij Narain's answer in The People, August 29, 1926.

As far as the debate between Professors of Economics was concerned, the Gold Bullion Standard was demanded by K.T. Shah, Brij Narain and P.A. Wadia. H.L Chablani claimed that the Gold Exchange Standard was good enough and opened himself to virulent criticism of the others as being an unpaid spokesman of the majority report. The People, August 15, 1926, pp. 141-48.

Findlay Shirras claimed that the Indian system was fully automatic. See, Findlay Shirras, Indian Finance and Banking, p.37. So did the Chamberlain Commission (see below). However, Brij Narain rejected this claim virulently in Brij Narain's "Essays on Indian Economic Problems, Part I", p.105 (published 1922).
possible logical explanation of such a stand was the assumption that if imported gold was hoarded and thus sterilised, prices may not rise. Alternatively, if gold did not come out of circulation for export when the balance of trade was against India, prices may not fall. The natural correctives to exchange would then not operate.¹ This was, however, on the assumption that hoarding would persist even after the introduction of a gold currency.² A fallacy that was perpetuated on the myth that the Indian peasant created a bottomless demand for gold, whatever his economic condition.³


² There was a very widespread belief that the bottomless habit of hoarding precious metal would ruin the monetary equilibrium of the country if granted a full-fledged Gold Bullion Standard.

"This (Gold Standard) cannot be contemplated for India until the habit of hoarding has been broken."

Midland Bank Review, August/September 1926, p.4.

³ A position hotly contested by many an Indian Newspaper which claimed that such reforms would certainly not cure the habit of hoarding.

Indian Social Reformer, August 14, 1926, p.779.
With this position of the Hilton-Young Commission, the government readily agreed for it meant the surrender of one of the main defences of the gold exchange standard. Keynes had claimed for the Indian system that it was as automatic as any other and that the only discretion exercised by the government was in the following two respects:

(a) They kept certain reserves of coined rupees in advance.

(b) By refusing to sell Council Bills they could only change the character of the demand and postpone it for a short time.

Ever since the time of Chamberlain Commission, government had come to look upon this argument as an effective answer to the critics of the gold exchange standard, but they had now executed a complete volte-face and were prepared to admit that its unautomatic character was one of the most serious defects of the system. 1

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1. The Chamberlain Commission of 1914 denied that the gold exchange system gave India 'an artificial and managed currency' under this system. "It is not, in fact, possible for the Government of India", says the Report of the Chamberlain Commission, "to manipulate the currency and they cannot add to the active circulation of the currency except in response to public demands."

A complete Gold Currency Standard that the commercial community had repeatedly asked for was rejected by the Commission. The approximate requirement for Indian currency under a Gold Currency Standard would be £103 million. Such a large demand, argued the Commission, would produce a fall in international prices and their repercussions would be inevitable on India as a unit of the world trade system.

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1. "It is estimated that the scheme for a gold standard worked out by the Indian Finance Department, assuming gold in circulation would require the acquisition of £103 million of gold over a period of 10-11 years quite apart from the sums going ordinarily into hoards. It is obvious that the absorption of gold on such a large scale would effect a serious appreciation on its value, in other words, a world wide and prolonged decline in commodity prices."

Midland Bank Monthly Review, August/September 1926

See also, Evidence of a foreign expert, Dr. Hollander, Hilton-Young Commission 1926, Evidence Vol. V, p.227, Para 15232.

There were opinions even in Bombay that warned those who advocated a full-fledged gold standard that the disturbances caused by the enormous purchase of gold and the equally large sale of silver would be against India's own interest.

Times of India, September 20, 1926; Article entitled 'Currency facts and Fallacies'.
Indian commercial opinion, however, disagreed. K.T. Shah showed that India's net balance of exports of merchandise was ₹1,881.94 crores between 1898-99 and 1925-26 of which she received ₹456.3 crores net in gold, or less than 25 per cent. Adding the total net silver import, in that period, of ₹208.5 crores, the gross import of precious metals amounted to ₹665.3 crores, or about 35 per cent. Had India's claim been fully satisfied, she would not be able to absorb annually more than ₹80 crores, which was the balance of trade in favour of India in 1925.\(^1\) ₹80 crores out of £50,000,00 a year at the very highest, would not be able to ruffle the general price level at all considerably; and so it

\(^1\) However, neither conclusion could be called undeniable. The acquisition of a gold standard was not envisioned as an insurmountable problem by many foreign witnesses and experts on currency.

Dr. Sprague's statement says that:

"It is entirely possible to finance this plan in the United States without any difficulty whatever if the plan itself appears to be desirable for all parties concerned."

_Hilton Young Commission, Volume V, p.295(ii)._

Keynes view that "£103,000,000 could be spared from the world's gold reserves and need have no material effect on prices or on the supply of credits."

_Ibid, p.145._
was alleged that the Hilton-Young Commission resolution was unsubstantial and of doubtful validity. ¹

What was interesting was that in the official rejection of the Gold Currency Standard the larger interests of Empire trade were held more important than India's demand for a stable currency. The Commission argued that if India adopted a gold currency, the price of silver was likely to fall. The enormous sale of silver and its drop in value would injure China which the Commission concluded was a most serious matter, for:

"...China is the greatest and perhaps the only great under-developed market left for the expansion of international trade."²


2. There was an interesting controversy over Sir Charles Addis's evidence. Brij Narain alleged that in the final report of the Currency Commission, there was a blatant and unauthorised plagiarism of the Evidence of English and American witnesses which went to show:

"1. The amount of original thinking that our currency commissioners did in attempting a solution to our currency problem.

2. The influences which are chiefly responsible for the rejection of the gold currency standard."

Needless to say, the Commission's reply was one of embarrassment at having been caught by such ungentlemanly conduct.

..../contd.
The commercial communities' nominal interest in the Chinese market made them critical of the Commission's interest in Imperial trading possibilities in the Far East. The Indian trade with China, both exports and imports aggregated in 1925-26, only Rs.1,802 lakhs against a total foreign trade in the same year of Rs.60,094 lakhs, or more than thirty times as much.¹

Though the arguments drawn from China and America² were

(Footnote contd.)


The Indian Daily Mail, September 10, 1926, Prof. Brij Narain.
"How the Currency Report was written."

See also, reply in The Indian Daily Mail, September 13, 1926.

1. The share of Great Britain in the foreign trade of China was 9.08 per cent in 1923 and 9.32 per cent in 1924; that of India 3.6 per cent in 1923 and 2.4 per cent in 1924. Of the total exports of raw cotton from India, China took 11 per cent in 1923 and 7.1 per cent in 1924 and Japan 46.4 per cent in 1923 and 45.6 per cent in 1924. That the dislocation of the Chinese trade might reduce China's share in our cotton exports to Japan and other countries did not worry the Currency Commission.


ii) Prof. T.E. Gregory, Para 21816.
iii) J.M. Keynes, Paras 12455, 12960.
iv) Joseph Kitchin, Paras 13384-85.
v) Sir Stanley Reed, Paras 15157-58.
vi) J.M.C.K. Forester, App., p.396.

not mere camouflage, the paramount reason why India was not allowed a gold standard was because Europe and particularly Great Britain had no intention of relaxing their hold on gold stocks that they had accumulated and were anxiously adding to.\footnote{1} The gold bullions standard recommended by the Commission was serviceable in terms of gold only to bullion brokers and the currency authority, did not undertake to guarantee the fluctuating rupee against bullion gold.\footnote{2}

B. Over the Ratio

The Commission recommended that at the present exchange rate of about 1s6d, prices in India had already attained a substantial measure of adjustment with those in the world at large.

\footnote{1} The Times of India, September 20, 1926, p.6.

"They will find it stated that whilst London and New York who work in close harmony, would strain every nerve to furnish India with credits necessary for her normal development, they could hardly be expected to furnish credits for the disturbance of the gold and silver markets of the world."

\footnote{2} See under listing 'Gold Standard' in the Index Volume to Hilton-Young Commission Report (1926), pp.28-33, Volume VI.
The statistical evidence on which this conclusion was made to rest, consisted of the changes which had taken place in the rupee-gold exchange and the corresponding changes in the index number of Indian prices in the course of the preceding three years.¹ During the eighteen months ending in June 1924, while the rupee was worth 1s3d gold, the rupee price level ranged round a mean of about 176.² In the succeeding year, while the rupee was rising to 1s6d gold, the rupee price level fell below 160. After that, while the rupee was rising above 1s6d gold, the price level ranged around a mean of about 158, with a tendency to fall in sympathy with world prices. On the strength of this evidence, the Commission felt convinced that:

"During the period of change, there was a mutual adjustment of prices and exchange, and that a substantial equilibrium was attained about the middle of 1925 and was maintained during the next year."³

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¹ Indian Trade Journal regularly published wholesale index prices both from Calcutta and Bombay. See for relevant years. See also, Statistical Abstract for British India for 1924, 1925 and 1926.

² This is assessed by comparing exchange value of the rupee, published monthly by the Report of the Controller of Currency and wholesale index prices available in Statistical Abstract for British India. Price indices are also available individually from the same source.

Having persuaded themselves that internal conditions such as prices, wages, etc. had been adjusted at the 18d ratio, the Commission held that an attempt to stabilise the rupee at 16d was sure to cause an unwarranted disturbance in all economic relations, without being beneficial to any except debtors, exporters, and employers of labour, and that too, during a short period of readjustment which would have to follow the change.¹

¹ Not everyone was convinced that the steady level of prices was beneficial to the Indian economy. Price fluctuations were not always a sign of economic malaise; the Bombay Chronicle went on to claim that fluctuating prices indicated a degree of healthy vitality. Because of this

"The bugbear sought by the Commission to be made out of a change in wages and dislocation of controls could be effectively counter-balanced by pointing out that after all, the variations in prices had been much greater between 1914 and 1920 than those between 1925 and 1926; and that when, as happens far more frequently, price variations are caused by purely economic factors the manipulation of the currency system will be of no real avail to check such variations even if it be desirable to do so. The whole argument is based on a fallacy and developed on a misapprehension of the real function or significance of price movements in the economic life of the country."

The Bombay Chronicle, September 2, 1926, 'The Rupee Sterling Ratio'.

See also, The Englishman, August 20, 1926, 'Sir Purshotamdas contra-mundum'. 
The Ambiguity of the Debate

The majority report's use of index numbers, on which they based their arguments regarding price adjustments to the 1s6d ratio, were by no means an infallible guide to the condition of the Indian economy. Sir Purshotamdas and Prof. Kale used the same statistical material to substantiate an entirely opposite conclusion. Kale argued that if Indian prices had been adjusted almost completely to world prices in 1926, then:

"the fall in the latter prices must be followed by a similar, if not exactly equal, fall in the level of prices in India."¹

Prof. Kale compared British wholesale prices and the Calcutta wholesale prices index and constructed the following chart²:

<table>
<thead>
<tr>
<th>British wholesale prices</th>
<th>Calcutta wholesale prices³</th>
</tr>
</thead>
<tbody>
<tr>
<td>Av 1913 - 100</td>
<td>Av July 1914 - 100</td>
</tr>
<tr>
<td>Av:</td>
<td>Av:</td>
</tr>
<tr>
<td>166.2 1924</td>
<td>140.9 1924</td>
</tr>
<tr>
<td>160.0 1925</td>
<td>136.9 1925</td>
</tr>
<tr>
<td>149.4 1926</td>
<td>129.6 1926</td>
</tr>
<tr>
<td>143.7 1927</td>
<td>126.9 1927</td>
</tr>
<tr>
<td>Av 173 1924</td>
<td>Av 159 1924</td>
</tr>
<tr>
<td>Av 148 1926</td>
<td>Av 148 1926</td>
</tr>
<tr>
<td>Av 148 1927</td>
<td>Av 137 1929</td>
</tr>
</tbody>
</table>

² J.C. Sinha, op. cit., p.51.
³ "The reason for using the Calcutta index rather than Bombay index is based on the fact that Jute and Jute Manufacture and tea figured more prominently in the export trade of India than cotton and cotton manufacture." J.C. Sinha, op. cit., p.16.
The figures show that between 1926 and November, 1929, while the British prices declined by about 15 per cent, the fall in Indian prices was only about 8 per cent. Therefore, the inference suggested is that there could not have been complete adjustment between internal and external prices in 1926. V.G. Kale accepts the maladjustment as revealed by wholesale price figures between 1926 and 1929. However, direct evidence of the same set of figures for 1924-26 would seem to establish something like a complete adjustment in 1926. Further, if considerable adjustment had yet to take place in 1926, Indian prices should have fallen more and not less rapidly than world prices. Because, in addition to the influences making for a decline of prices, which India would be sharing in common with the rest of the world, she would be subjected to a further influence of an over-valued rupee exchange, that would increase the downward pressure on prices. Was this entirely valid?
There were a number of conditions on which the level of prices depends. Increased demand, for instance, can alter price indexes in a more powerful fashion than 12.5 per cent increase or decrease in the value of the rupee. In the following table, between 1922-23 and 1924-25, Indian exports climbed to a post-war high of 400.24 crores of rupees.¹

<table>
<thead>
<tr>
<th>Year</th>
<th>Imports</th>
<th>Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1919-20</td>
<td>222</td>
<td>336</td>
</tr>
<tr>
<td>1920-21</td>
<td>347</td>
<td>267</td>
</tr>
<tr>
<td>1921-22</td>
<td>282</td>
<td>248</td>
</tr>
<tr>
<td>1922-23</td>
<td>246</td>
<td>316</td>
</tr>
<tr>
<td>1923-24</td>
<td>237</td>
<td>363</td>
</tr>
<tr>
<td>1924-25</td>
<td>253</td>
<td>400</td>
</tr>
<tr>
<td>1925-26</td>
<td>236</td>
<td>386</td>
</tr>
<tr>
<td>1926-27</td>
<td>261</td>
<td></td>
</tr>
<tr>
<td>1927-28</td>
<td>261</td>
<td>330</td>
</tr>
<tr>
<td>1928-29</td>
<td>263</td>
<td>339</td>
</tr>
</tbody>
</table>

1924-25 was a record year for the Indian export trade. Stocks of Indian goods in foreign markets were low at the beginning of the year, demand was strong and there was a general rise in the sterling price of Indian

Exports, the rise in most cases being appreciably greater than the rise in the sterling value of the rupee to 1s6d, in 1924-25. The fall in the value of the exports in 1926-27 was mainly the result of a fall in quantity as well as value in the exports of raw cotton, and a fall in the value of the exports of raw and manufactured jute was because there was a drop from the high prices of the last few years. Fluctuations in demand for Indian goods (which would have had an effect on wholesale price indexes) were difficult variables to estimate. Europe only got rid of her war time legacies of tariff barriers with rapid fluctuations in tariff rates, contraction of credit of production and purchasing power by 1927-28, when Britain recovered from a prolonged coal strike. Italy returned to the gold standard and the French exchange achieved stability in the same year. Even these overall trends could be upset by temporary shortages which made wholesale price indexes difficult to analyse or explain.

Certainly, a 12.5 per cent increase in the value of the rupee from 1s4d to 1s6d had an irregular effect on the post war Indian economy. However, because of the absence of detailed statistical material, it is almost impossible to estimate accurately whether adjustment to the new ratio had or had not taken place.1 The ambiguity of the argument between those who supported the 1s4d rupee and the government who legislated a 1s6d rupee was almost endless. Government could counter each attack on official manipulation with an equally convincing and equally facile argument that was theoretically undefeatable.

What answer could there have been to the government's assertion that the steadiness of the exchange was because of the normal addition of currency

1. Purshotamdas the main advocate of the 1s4d rupee was very heavily criticised for his insistence on this marginal reform by many in Bombay including a reputed newspaper, The Bombay Chronicle, which said:

"... naturally exposed himself (i.e. Purshotamdas) to the criticism (of Basil Blackett) when he insists on a meticulous point of detail. The point about the exact ratio of exchange between the silver rupee and the gold standard unit is a mere matter of purely internal and that wholly temporary concern."

The Bombay Chronicle, August 10, 1926, 'Currency Legislation'. There was undeniable support for Purshotamdas from the Bombay Press. See, The Daily Mail, August 14, 1926, 'The Currency Commission'.

during a busy season and an equally normal contraction at the end of it; not as its critics imagined due to manipulation of the exchange. This was, of course, inferred from the belief that the period of adjustment was over and that the 1s6d ratio had created an equilibrium that a lower rate would disturb. The Majority Report's argument in support of the higher ratio was as comprehensive as it was unassailable and grew to become the most controversial and inflammatory element in the entire debate.

1. H.L. Chablani in opposition to the radical Professors of Economics, K.T. Shah, Brij Narain and P.A. Wadia, dismissed the demand for a full-fledged gold standard. His only quarrel with the majority report was over the question of price adjustment. He said:

"Part IV of the Report is the only portion to which strong exception can be taken. It is perfectly true that the Indian Exchange rose automatically between July 1924 and October 1924 as a result of the revision of world prices. But when the world prices began to fall, after February 1925, Indian Exchange would have automatically fallen if the Finance Member had abstained from manipulating a fall of prices. The fall in prices was in no sense an automatic adjustment of prices to an existing defacto rate; the Finance Member's manipulation was rather an interference with the natural tendency towards a fall in exchange which would have materialised into a fact if Indian prices had been allowed to remain steady just as was done when world prices rose between July and October 1924."

H.L. Chablani was very close to Purshotamdas, and whatever the merits of this argument it certainly would represent the feeling of a good portion of the Bombay commercial community. Brij Narain went as far as to accuse Chablani of being a stool pigeon of the Bombay commercial community.

Most of the remainder of the Report revolved around whether adjustment had actually been attained. As far as wages were concerned, the Commission argued that when exchange and prices had been steady over a considerable period, there was justification for assuming that wages were also in adjustment unless there were clear indications to the contrary. ¹ The statistics of foreign trade, argued the Commission, appeared to strengthen the assumption. The depression in agriculture pre-eminently 'India's greatest industry' was, in no way, due to lack of adjustment between agricultural wages and the exchange.

As to the manufacturing industries, in the jute mill industry in Bengal, the wages were in line with the existing price level and cost of living. ² The steel industry was suffering not so much from high wages as from the stress of foreign competition, stimulated in the case of some countries, for example, Belgium, by depreciating exchanges. ³ In the cotton mill industry,


2. 'Decrease in some industries of wages and salaries', Hilton-Young Commission; See, Sir Stanley Jevons, official witness, Para 9277/8.

3. Ibid., Para 9279.
the Commission believed that wages were apparently too high. The majority report explained that whereas the index figure of wages for mill hands were 231, the index numbers of wholesale prices, retail food prices and cost of living were all around 150.

The Commission admitted that many of the current land revenue settlements had been made when exchange was at 1s4d, but in view of the great rise in prices since 1914, the real incidence of land revenue, measured in terms of commodities had been materially lightened and that the 1s6d rate could not be regarded as constituting great hardship. In any case, the Commission believed that after the prolonged disturbances since the war, it was impossible to do absolute justice to the long term creditor or debtor by fixing any particular rate of exchange.¹

The Minority Report

The minority report was equally energetic in defence of the lower rupee. Sir Purshotamdas, in his minute of dissent, argued against a great many of the recommendations of the Committee.² He believed that

1. Hilton-Young Commission. The official arguments are presented as criticism; See, T.K. Duraiswami Aiyar, 'Land Revenue', App., p.349, Para 9806; See also, 'Creditors and Debtors', Dr. Promathanath Banerjee, 6766-7067, App., pp.252-55.

no adjustment in wages had taken place and none was likely without a struggle.\(^1\) Judging from the report, this was to some extent true. No statistical evidence had been produced by the Commission's Majority Report to show that agricultural wages were in adjustment.\(^2\) On the contrary, Purshotamdas gave figures indicating that no decline in agricultural wages had occurred. He asserted that in the case of government services, the Majority Report was driven to resort to the negative and unsatisfactory argument that the 1s6d ratio had prevented an increase in salaries of government servants which would otherwise have been inevitable. Further, it was only as regards the jute industry that they were able to make the positive assertion that wages were in correspondence with current prices and cost of living. In the case of cotton industry, the Commission was compelled to admit a serious maladjustment between wages and prices.\(^3\)

\(^1\) On the question of wages Purshotamdas advanced figures to show that since the fall in Indian prices which began in 1922, nominal wages had not adjusted themselves to the new level of purchasing power, and that the present average level of real wages lay somewhat between 50 per cent and 100 per cent above the 1924 level.

The Statist, September 11, 1926, p.387.

\(^2\) Victor Sassoon was in full agreement with Purshotamdas Minute of Dissent. See, The Bombay Chronicle, August 6, 1926, 'The Poor Penalised'.

\(^3\) Ibid., p.6.
Purshotamdas' anxiety over indigenous industry encouraged him to suggest that until this adjustment was complete the 1s6d ratio presented the foreign manufacturer with an effective, though indirect bounty of 12½ per cent which had placed a heavy strain on Indian industry\(^1\) having been forced up on the plea of stabilising internal prices,\(^2\) had resulted in foreign imports pouring into the

1. The Statist was of the opinion that:
   "On the parity question that the opinion of the majority and that of the dissenting member are irreconcilably divergent and were it not for this difference of opinion we are fairly confident that a unanimous report would have been presented."
   The Statist, September 11, 1926, p.387.

2. Stability of prices was considered an important reason for the manipulation of the exchange rate.
   "Obviously it would be a far better plan to aim at stabilising internal prices in India than to allow the rupee to roam."

This was not what industry recommended. Even the Bengal Chamber, though it largely agreed with the government on the question of the ratio, said about stability:

"From a mercantile point of view the Chamber would favour stability of exchange, as against comparative stability of prices brought about by fluctuating exchange."


Evidence on behalf of Campbell, Kenneth and Rushforth 6702-7920, App., pp.277-82, Letter from Secretary regarding proposed discontinuance of one rupee note and statement App., pp.277-82.
country. Every industry in competition with foreign industries was having a rough time and the only industries that were able to stand the intense foreign competition were the monopolistic industries like Jute and Tea.

1. There was a general and widespread feeling in Bombay that imports had damaged Indian industry. K.R.P. Shroff, the President of the Bombay Stock Exchange Board, in an interview with the Chronicle said:

"This ratio (1s6d) has undoubtedly killed our industries, especially the new industries, because they had to compete with imported articles which were cheaper on account of the higher exchange."

This was as Purshotamdas alleged a 12½ per cent exchange bounty on imports. The Statist reported that the Manchester Chamber

"... is greatly satisfied and consider the 18d ratio most favourable to Lancashire, leading to a revival of its Indian trade."

See, Bombay Chronicle, August 13, 1926, 'India faced with disaster'. Also, The Bombay Chronicle, report on the Statist position in regard to the Currency Commission Report, August 11, 1926. The Bengalee, November 20, 1926, p.4. 'The 18d Rupee, a bounty to the Importer'.

2. See, IMC Annual General Meeting 1930. Presidential Speech by Hooseinbhoj Laljee. Report of the IMC for the year 1930. This was to continue as a persistent complaint of the commercial community all throughout the thirties. Speech by President of the BM0A, N. Chandarvarkar. Report of the BM0A for the year 1936. See also, the Vice-President of the BM0A, his speech to the Annual General Meeting for the year 1933, Report of the BM0A for the year 1933. Also a letter from the AM0A to the Secretary, GOI from G.I. Patel dated February 6, 1935 in the Report for the year 1936. About the monopolistic industries of Jute and Tea it was undoubtedly true that all other things being equal the product would always sell, despite the exchange penalty of 12½ per cent. A Merchant wrote to the Englishman in criticism of Purshotam's position saying:

.../contd.
The defendants of the lower ratio claimed that the over-valued rupee had prejudiced indigenous industry in another important way. Pherozeshah Dalal warned that the raising of the exchange had led to the lowering of the rupee price of gold from Rs.24 per tola to Rs.21.3 per tola, i.e. the price prevailing in 1925. This lowering of the price had led to enormous imports of gold in the recent years, the import for the year 1924-25 being 73.8 crores.

(footnote contd..)

"As a Merchant, I have yet to learn that an increase or decrease of duty or tax, effects the seller directly. The buyer is the direct loser or gainer. If that is so the buyer of Jute and Tea who lives in countries outside India, will certainly profit to the extent of 12½ per cent, or lose to the same extent. It must be noted however that whether a lower or higher ratio, India having a monopoly of the above goods will always sell their stuff."

Englishman, November 12, 1926, Letter to the Editor.


a) Gold in circulation 4888 - 4889
b) Import of gold 4824 - 32, 5001-6, App., p.203(5)
c) Issue of gold 4892, 4981-3, App., p.206(22)
d) Minting of gold App., p.206(2)

The surplus savings of the country were being diverted more and more into gold.¹ This was particularly hurtful to textile interests in Bombay, who by the 30's were vigorously asking for a greater return for the producer and agriculturist.² Reduced earnings would have a detrimental effect on indigenous industries, and as a number of businessmen pointed out, also on Lancashire which would not be able to sell the quantity of piece-goods to India

1. Pherozeshah Dalal went on to say about the enormous bullion demand

"This is having a detrimental effect on indigenous industry.... It is stated by some that India will soon get saturated with gold at the lower price, but my experience as a bullion broker for the last 3½ years is that India is never saturated with gold and that if the present low level of gold is maintained she will continue to absorb large quantities of gold except in years of scarcity, to the great detriment of her economic development."


2. AMOA and BMOA, See Presidential Speech for the years 1933, 1934, when demand for protection were the highest.

goods to India which she would have otherwise done.¹ The commercial community pleaded that this large import of gold was having a serious prejudicial effect on the industrial and financial development and could only be checked by reverting to the 1s4d ratio. As a result, vast quantities of the savings of the country would be diverted into productive channels rather than being sterilised by the purchase of gold.

The minority report attacked the ratio in a manner that recalled much of the work of the Indian Currency League and the Bombay commercial community. The agriculturist, the debtor, the exaggerated official concern over public finances, much of this was well known dogma and repeatedly used to bombard the official 1s6d rupee.

But it was Purshotamdas' Report that for the first time systematically organised the defence of the 1s4d rupee. As far as the agriculturist was concerned, a change in the ratio would mean an

¹. Indian Tariff Board (1934), Indian Chamber of Commerce, Calcutta Imperial preference and Swadesh, App.23, Vol.III, ITB, p.34.
additional burden of 12.5 per cent on the large bulk of the debtor class who were agriculturists and whose total indebtedness had been estimated at 600 crores for British India alone. Being debts of long standing, it was natural to assume that it was mostly contracted on a 1s4d basis.1

The adverse effect on public finances of a reversion to 1s4d had been exaggerated. Purshotamdas felt that against the increased rupee expenditure in regard to sterling liabilities in London, there would be an increased customs revenue of Rs. 2.62 crores under the 1s4d; increased receipts from income-tax owing to industries being spared the disturbance inseparable from 1s6d, and the avoidance of bounties to industries as a cover against foreign competition. Moreover, whatever the advantage to the government, it was paid for by the

1. The Statist was of the opinion that:

"It is on the parity question that the opinion of the majority and that of the dissenting member is irreconcilably divergent and were not for this difference of opinion, we are fairly confident that a unanimous report would have been presented."

The Statist, September 11, 1926, p. 387.

"Sir Purshotamdas points out that this view (1s6d) ignores the larger indebtedness which is estimated at 800 crores of rupees a greater part of which can be safely said was incurred before 1917."

.../contd.
producer who had to accept so much less in rupees for his produce.

The adverse effects of 1s4d on a small section of the population consisting of the poorly paid member of the literate classes (receiving fixed income) must be allowed less weight claimed the minority report than the suffering which the higher ratio would entail in the case of the remaining 79 per cent of the total population.

(footnote contd...)

Purshotamdas argued that if it can be proved that the ratio of 1s6d the new defacto ratio than that figure should stand. If there was no case for adding 12½ per cent to the debt of every debtor in this country.

As to labour, Sir Purshotamdas argued that the existing rate of wages was sufficiently high to cover a possible rise in prices caused by the adoption of 1s4d.

"It is contended that in the present depressed conditions of Indian industries, wages would have to be lowered in order to ensure their adjustment to a 1s6d rupee parity. Every reduction in money wages has been bitterly resisted even though it may have entailed no reduction in real wages. According to Sir Purshotamdas revision is a 1s4d ratio would make it possible to retain wages at their present nominal level whereas an adjustment in wages to the 1s6d basis will entail a long and bitter struggle between labour and capital."

The Statist, September 11, 1926, p.382.

In any case there was the compensatory advantage of a continuity of employment due to the fact that the lower ratio would ensure greater prosperity to industry and agriculture, while the higher ratio was sure to injure both.

See also, P.T.Mss 55, correspondence relating to his work on the ratio question. Letters mostly express the views of various individuals on ratio question. Seth Govind Das, B.F. Madan, D.G. Kante, Jamnadas Dwarka, Sir Stanley Reed, G.D. Birla and others.
Inspite of his systematic presentation, Purshotamdas's plea for a lower ratio was not an academically rigorous computation. His claim that the agriculturist must have lost materially because of the ratio, could only have been checked in reference to:

a) the decline of capital deposits in rural society;
b) the proportion of outstanding arrears after the 1s4d ratio had been legislated;
c) the increased rates of interest on loans;
d) the increased loans for unproductive purposes like repayment of debt.

Again, assessing rural debt would not solve the problem entirely. If it were possible to determine what percentage of the new liabilities mortgaged to sahukars and mahajans all over the country were consequences of the new ratio, as separate from the normal effects of worldwide depression, it might have been possible to present a reasonable argument.

It would be more difficult to support Purshotamdas's conclusion with regard to wages and the manufacturing industry. If the transition to the new ratio 1s6d had been less than 50 per cent, complete which is in essence the debate, then there was no guarantee that the subsequent rise in prices would not have been taken advantage of by mill owners unwilling to grant any benefit to their labour despite high price.¹

¹. Argument that the Hilton-Young Commission used again and again.
Fundamentally, the ratio's 'natural level' fluctuated in sympathy with the balance of trade. Any substantial adjustment either way would have created conditions of financial uncertainty. A high ratio would favour low prices, decreased imports and financial benefits for the Government of India, a low ratio would encourage industry and facilitate exports. But in rooting for the higher ratio the government made a critical error.

Deflation of the Rupee

1924-25 was an unusually prosperous year for Indian exports, but despite the official belief to the contrary this prosperity was not to continue.2 The government

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1. The 'natural level' or 'natural ratio' was frequently used by both sides of the exchange debate which is why it is a qualified phrase. For instance, an article in the Daily Express:

"The proposal to stabilise the rupee immediately at 1s6d is often open to objection on other grounds. The chief of which is that it is not a natural ratio, that the rupee has been kept up at this rate by the familiar method of the deflation of currency."

Daily Express, August 10, 1926, p.6.

2. What is notable is that the decline in commodity trade was foreseen by witnesses that the Commission examined. It was the contention of the East India Section of the London Chamber of Commerce that the 1s6d exchange was the result of good monsoons for five years in succession and that:

"should the favourable cycle be broken it may be found that the normal exchange value of the rupee will be nearer 1s4d than 1s6d."

believed that incomes and savings, and in particular trade and industry would continue on the same scale, which would allow these resources to be tapped through taxation and public loans. During the subsequent years 1926, 1927 and 1928 exports declined, the favourable balance of payments position shrank, and the Government of India soon found itself in trouble trying to maintain the value of the rupee at the officially legislated exchange.¹

¹. Pherozeshah Dalal and B.F. Madon of the Indian Merchants Chamber were well aware that the heavy favourable balance of trade in 1923-24 was artificially created by an enormous demand for raw cotton owing to short crops in America. It was not safe, they believed to assume that the world would continue to buy large quantities of Indian cotton at considerably over pre-war prices. The development of cotton growing in the world, particularly in the British Empire and countries under British influence pointed in future to a smaller demand for Indian cotton, which would have made the maintenance of the 1s6d exchange a cumbersome exercise. Pherozeshah Dalal believed that when the demand for Indian cotton fell, eventually -

"...the government must resort to fresh currency manipulation to maintain exchange at 1s6d with a repetition of the disastrous consequences to the finances and the industries of the country."


The Bombay Chambers, including the Ahmedabad Millowners Association were unhesitatingly critical of the government manipulation that had become necessary to maintain exchange and quoted instances where the government regardless of strong protests from the country, and the economic consequences allowed deliberate deflation.¹ Pherozeshah Dalal pointed out that government remittances added to private remittances totalled ₹100 crores per annum and could be well taken care of in years of big harvests, but when exports fell, their remittances were made by a contraction of currency which led to financial and industrial harassment.² The exchange,

1. This became an outspoken criticism during the Hilton-Young Commission when AMOA and BM0A suggested the Reserve Bank. See also, Report of the BM0A for the year 1927-28.


2. There are numerous examples of monetary disequilibrium created by the need to maintain remittance. One incident which created a much publicised controversy was in October 1926 when the government contracted 7 crores of rupees through the paper currency to ensure remittance and Basil Blackett justified the measure claiming that cash balances of the Imperial Bank were in the region of 50 crores. Thakurdas claimed that this was not the entire story, petitions by commercial bodies and Thakurdas in regard to this contraction.

"reminded the Finance Member that the crops in India are large and will require to be moved shortly and any deflation of currency is bound to lead to tightening of the money market when crops to begin to move."

This contraction despite repeated protests was carried out whenever remittance had to be effected, usually on the express orders of the Secretary of State. Indian Daily Mail, October 10, 1926, 'Basil Blackett, and irresponsible banker'.

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he advised, should be fixed between gold and the rupee to enable these remittances to be made year after year without hindrance.\footnote{1} Had India been granted a full-fledged gold currency, or if the management of note issue had been handed over to a Bank, the commercial community believed that either of these two options would have dissolved the more serious abuse of currency manipulation.\footnote{2}

The situation was to grow much more serious in 1929 with the American Stock Market collapse.

\footnote{1} P. S. Dalal, Loc. cit., Hilton-Young Commission.

\footnote{2} There were differences between the Bombay spokesmen and British Press opinion on the inauguration of a central bank (or the conversion of the Imperial Bank into a Central Bank without its commercial banking business). Financial circles in London argued that the Imperial Bank should continue as a commercial bank as it was already playing an important part in fostering the habit of banking and investment. Both the Times and the Financial Times went on to assess the Bombay plea for a lower rate as a sectional point of view, and that of manufacturers.

"... concerned in industries in which capital and credit were frozen fast in the post war slump and who gladly welcome a measure of inflation in order to thaw themselves out."

The Times of India, August 21, 1926, p. 2, 'The Currency Report'. See also, the reply from The Bombay Chronicle, August 23, 1926, Article by R. C. Saraiya.

There were differences of detail even among the Bombay businessmen, but they were roughly agreed that the responsibility of note issue should be taken away from the Finance Member. The Indian Daily Mail, October 4, 1924. 'The Proposed Reserve Bank'. See also, The Englishman, August 6, 1926, 'Support from Clive Street'. 
In the years immediately after the stock market collapse the American crisis handicapped commercial activity all over the world and prices fell rapidly. In India, the prices of agricultural produce and raw materials suffered most of all, and the principal Indian exports of cotton, jute, coffee and groundnuts, were badly hit. The steel industry suffered from reduced expenditure on railways which was a part of the general policy of curtailment of capital investment.

1. The fall in prices of primary products was more substantial than of industrial commodities. S.N. Sen Gupta explains this because -

"it appears that the prices of the primary commodities had been falling since the beginning of 1926, so that even if there were no crisis in 1929, it is likely that India would have suffered from a mild agricultural depression which would have been at its worst in 1930 or 1931. As it is, the world depression aggravated the situation. But for it we should have been well on the way to recovery by 1933 and further the fall in the prices would not have been so disastrous."


The government alleged that the fall in prices was created by the political situation, which was a euphemism for the outbreak of Civil Disobedience in the country. The IMC and the Indian Chamber of Commerce Calcutta, vehemently opposed such a suggestion but there were those like H.P. Mody, President of the BM0A who felt the Civil Disobedience Movement was causing irreparable damage to the interests of Bombay. The Bombay Chamber of Commerce in its preamble on the Economic situation in Bombay admitted that the world fall in prices had a part to play in the depression of trade, but it was the Civil Disobedience Movement that had greatly aggravated the situation.

See, Report of IMC for the year 1930, pp.36-37.
Report of BCC for the year 1930, pp.36-87.
programmes adopted by the government. The jute industries were doing badly as the external demand for their goods from Australia, USA had greatly slackened. The cotton industry which, in view of the new tariff, had just begun to look forward hopefully to better terms after its recent troubles, was again called upon unexpected difficulties owing to a sudden collapse of prices.

In these circumstances, government found themselves even more severely compelled to take special financial measures to maintain exchange at 1s6d. The first method adopted was currency contraction, the net amount of which during 1929-30 was Rs.1,080 lakhs. The contraction was affected largely by the transfer of sterling securities in the paper currency reserve to the Secretary of State for his sterling expenditure against a cancellation of currency in India, and also by the cancellation of rupee securities in the paper currency reserve and the sale of silver in that reserve. The second method was the issue of Treasury Bills to exchange banks and other purchasers so as to control credit in the interest of a firmness of exchange. Lastly, the bank rate of the Imperial Bank was raised to 6 per cent early in October 1929 and to 7 per cent in the same month, which was quite an abnormal step as the cash balance of the Imperial Bank was then very large, about Rs.30 crores.²

1. Brij Narain, India Analysed and Indian Economics. This is a standard information on Financial History, 1929-30.

And call money was freely available in Bombay and Calcutta at around 2 per cent because trade demand was dull as the busy season had not yet commenced.

The opponents of the 18d ratio, believed that as so much management and manipulation had been found necessary to maintain it two and a half years after it had been put on the statute book, conditions could not have yet become adjusted to the 1s6d ratio. Another circumstance which was interpreted to show the unsuitability of the 18d ratio was the difficulty experienced by government in securing the necessary sterling funds for remittance to London.

1. The ICC was particularly vehement. The government in the attempt to maintain the 18d ratio had adversely affected commerce, industry and the agriculturist who had undergone a very serious setback because of this disastrous policy:

"It was pointed out that manipulation of various kinds have had to be resorted to by the government with a view to create artificial stringency and unjustified high money rates in India. During the year 1929-30, the government controlled currency to the tune of Rs.29.86 crores, and during 74 months of the year 1930-31 to the extent of 29 crores... summing up the entire position it was pointed out that the Government of India were responsible for frittering away Rs.113.30 crores of gold assets that (between 1926 and 1930) they undertook upon themselves against the unanimous public opinion of the country."


2. See J.C. Coyajee's Chapter on Deflation in India op cit. Also AMOA Seth Chamanlal Parekh, President for the year 1930. AMOA at the Annual General Meeting, July 26, 1930. Report of the AMOA for the year 1930. President's Speech, pp.iii-xiv.
Government were unable to purchase sterling at satisfactory rates from April 1st to the end of May 1929 and although they announced towards the end of June that they would make discretionary purchases in the open market from time to time, they could only secure £30,000 up to August 24th at the rate of 1s5½d. Conditions gradually improved and by the end of December exchange reached 1s5d. Upto the end of 1929, government was unable to remit £13,790,000 by open market purchases, but it was found necessary to supplement purchase of sterling by the transfer of £9.5 million from paper currency reserve and a sterling loan of £10 million in January and £12 million raised by short term treasuries.¹


"Committee Indian Chamber of Commerce, Calcutta, bear a strong report that government propose to transfer sterling securities from Gold Standard Reserve to Paper Currency Reserve and corresponding amount of gold from Paper Currency Reserve to Gold Standard Reserve with a view to draw reserve councils and contract currency to that extent."

For detailed figures on amounts of contraction and transfer from reserves, see communication addressed by the President ICC, Calcutta to Hon'ble Finance Member, G.O.I. New Delhi dated November 26, 1930. Report of the ICC for the year 1930, Report Vol., Appx IV, pp.194-96.

See also for sterling loans:

As against the suggestion that the remittance difficulties of government indicated a failure of the 1s6d ratio, Sir George Schuster, in an address to the Indian Merchants Chamber, pointed out that to expect the exchange to remain wholly unaffected by the extremely abnormal and unsettling condition of 1929 was to ask for too much.

It is difficult to assess Sir Schuster's belief that currency deflation could not entirely have been the consequences of the 18d ratio. It could be argued that the government had been forced to shrink currency to prevent a drain of funds to the high money markets of New York. Yet, it could also justifiably be claimed that the government was guilty of bolstering up the exchange artificially in order to effect its own remittances.¹

It was no longer a question of whether adjustment had or had not taken place to the new ratio. But, if the mill owners claim of the 18d ratio being artificially high

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¹ They protested as did the ICC, Calcutta, that:

"The total amount of such contractions since the beginning of the calendar year was as high as 17 crores of rupees; and they drew the attention of government to the serious effect which the withdrawal of such a substantial amount would have on the Indian money market."

See Report of the IMC for the year 1930, p.27.

A summary of a letter No.2015 dated June 11, 1930 from Chamber to G.O.I., Fin. Dept. The figures of the IMC and ICC Calcutta differed because they reported to government at different times of the year. (Report Vol. 1930).

See also a Committee of the IMC and its interview with the Finance Member.

was substantially correct, then the government could be accused of contributing to the depression by starving business of credits. The whole debate was substantially modified when sterling went off gold.

**Sterling off Gold**

On September 21, 1931, the British Government, in consultation with the governing body of the Bank of England, cancelled the obligation on the Bank to give gold bars in exchange for sterling. Once this obligation was removed, sterling was divorced from gold and England was off the gold standard. Sterling no longer convertible into gold began to depreciate steadily. The influence of depreciating sterling on the Indian rupee was important because on the same day the rupee was officially delinked from gold and reattached to the sterling exchange. This was to have an important influence.

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1. With the abrupt depreciation of sterling in terms of gold, the rupee price of gold in the Indian market showed a rise. The rise in the rupee price did not take place to the same extent of the depreciation in sterling because of the artificially pegged value of the rupee and the differing values of rupee and pound sterling on the world market in spite of a formal rupee-sterling connection. Thus gold began to be exported, as the differentiation in price between internal and external markets encouraged large profits on its exports. Commodities gained a favourable price advantage in spite of the over-valuation of the rupee, but only in relation to countries still based on gold.

See, publication of five essays by Bengal Publicity Board. This was a pro-government agency responsible for advocating views against the 164d ratio, the gold bullion standard and so on.

'Current Economic Problems of India', p. 77, Bengal Publicity Board.
on currency and exchange in India. The rupee in relation to gold or currencies based on gold depreciated along with sterling. The depreciation of the rupee tended to stimulate exports to countries having currencies based on gold and to discourage imports from them. In actual fact, the stimulus to exports was in large part neutralised by declining world prices and high import duties and other restrictions imposed by most of such countries.

As for imports from these countries, they became dearer in the Indian market and the British goods obtained an advantage in competition with Indian manufacturers, a sort of preference by the back door. The advantage was not enjoyed for long because other countries too either went off gold or devalued their currencies one by one.

The following table shows the index numbers of wholesale prices in Calcutta:

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual Average</th>
<th>Year</th>
<th>Annual Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>1914</td>
<td>100</td>
<td>1925</td>
<td>159</td>
</tr>
<tr>
<td>(end of July)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1920</td>
<td>202</td>
<td>1926</td>
<td>148</td>
</tr>
<tr>
<td>1921</td>
<td>179</td>
<td>1927</td>
<td>148</td>
</tr>
<tr>
<td>1922</td>
<td>176</td>
<td>1928</td>
<td>145</td>
</tr>
<tr>
<td>1923</td>
<td>172</td>
<td>1929</td>
<td>141</td>
</tr>
<tr>
<td>1924</td>
<td>173</td>
<td>1930</td>
<td>116</td>
</tr>
</tbody>
</table>

(Footnote contd...) Brij Narain alleged that when sterling and the rupee went off gold in September 1931, these should have shown a rise in Indian prices.

A fall in the gold value of the rupee of 33\(\frac{1}{3}\) per cent should have produced a rise of 55 per cent in proper prices in India. "But not only have our prices not risen, but they have fallen with gold prices."

Brij Narain 'India in the Crisis', p.179.

1. SOURCE: Brij Narain, India Analysed, p.103.
It will be seen that the annual average for 1930 was 16 per cent above the pre-war level (July 1914), but prices continued to fall in 1931, the index number registering 92 in August of that year. The abandonment of the Gold Standard and the linking of the rupee to sterling at the end of September led to a temporary revival of business activity, and prices climbed upwards.

1. When sterling abandoned gold on September 21, 1931, since the rupee was linked to the pound, the external value of the rupee fell which led to the temporary rise in prices of exported commodities. However, opinion in Great Britain in September 1931 favoured resistance to the depreciation of sterling. Britain's involvements abroad, her food supply, her large import of raw material all contributed towards the bias for an over valuation of sterling. Thus, a depreciating rupee could not be allowed to endanger the position of sterling in the world financial markets. As a consequence the G.O.I. was instructed by the India Office to limit the sale of sterling, yet maintain an official claim to a rupee-sterling link. On the September 24, 1931 by Ordinance VII 1931 of the 'Gazette of India Extraordinary', sterling sales were restricted. At the same time instructions from the India Office ordered the currency authority to contract vigorously, as a result of which gold prices fell. Once gold prices fell (below gold export point), the export of the metal was freely allowed bolstering up India's exchange position which reached 1s6d and then remained above par from December 28, 1931. It was only then that monetary equilibrium was reached to the satisfaction of the India Office whose priority was sterling and Empire monetary unity rather than currency equilibrium in India.

from September 1931 to February 1932, the index number rising from 92 in August 1931 to 97 in February 1932.

After that, excepting a rise of 4 points in August 1932, prices continued to fall till March 1933 when the index number stood at 82, or at a level lower than that of August or September 1931.

The statement on the following page shows the value of our foreign trade during the five years between 1928-29 and 1932-33.

The increase or decrease in total exports including re-exports and imports of merchandise in each year as compared with the preceding year is shown below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Export</th>
<th>Import</th>
</tr>
</thead>
<tbody>
<tr>
<td>1929-30</td>
<td>-6</td>
<td>-5</td>
</tr>
<tr>
<td>1930-31</td>
<td>-29</td>
<td>-31</td>
</tr>
<tr>
<td>1931-32</td>
<td>-29</td>
<td>-23</td>
</tr>
<tr>
<td>1932-33</td>
<td>-15</td>
<td>+5</td>
</tr>
</tbody>
</table>

The heaviest fall both in exports and imports, occurred in the financial year 1930-31 when, as compared with the preceding year (1929-30), imports declined 31 per cent and exports 29 per cent.¹ In the following two years

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¹. The total visible balance of trade, which of course included the export of bullion, strengthened exchange and reduced the price of commodities internally increasing the price of exported articles. In spite of gold sales worth 183 crores, prices did not rise remarkably. This was because gold exports merely substituted the normal purchasing power of the cultivator which he realised through commodity exports. Brij Narain says:

"Under normal conditions the acquisition of new purchasing power amounting to 183 crores would have sent prices up with a rush."

Brij Narain 'India in the Crisis', p.107.
the decline of exports continued; the value of exports falling from 225.6 crores in 1930-31 to 160.6 crores in 1931-32 and 135.7 crores in 1932-33; but the decline in 1932-33 shows a rise of 5 per cent as compared with 1931-32.

The following table shows imports from and exports to four leading countries:

### India's Pattern of Trade 1928-1933

<table>
<thead>
<tr>
<th></th>
<th>1928-29</th>
<th>1929-30</th>
<th>1930-31</th>
<th>1931-32</th>
<th>1932-33</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IMPORTS FROM:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.K.</td>
<td>113,24</td>
<td>103,10</td>
<td>61,28</td>
<td>44,81</td>
<td>48,77</td>
</tr>
<tr>
<td>Germany</td>
<td>15,84</td>
<td>15,79</td>
<td>12,38</td>
<td>10,20</td>
<td>10,37</td>
</tr>
<tr>
<td>Japan</td>
<td>17,67</td>
<td>23,59</td>
<td>14,51</td>
<td>13,34</td>
<td>20,50</td>
</tr>
<tr>
<td>U.S.A.</td>
<td>17,36</td>
<td>17,66</td>
<td>15,15</td>
<td>12,84</td>
<td>11,25</td>
</tr>
<tr>
<td><strong>EXPORTS TO:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.K.</td>
<td>69,04</td>
<td>66,55</td>
<td>51,77</td>
<td>42,85</td>
<td>37,55</td>
</tr>
<tr>
<td>Germany</td>
<td>32,32</td>
<td>26,57</td>
<td>14,26</td>
<td>10,28</td>
<td>8,00</td>
</tr>
<tr>
<td>Japan</td>
<td>34,34</td>
<td>32,26</td>
<td>23,73</td>
<td>13,94</td>
<td>13,95</td>
</tr>
<tr>
<td>U.S.A.</td>
<td>39,11</td>
<td>36,11</td>
<td>20,65</td>
<td>13,86</td>
<td>9,76</td>
</tr>
</tbody>
</table>

Attention may be drawn to the increase in imports from Japan and the U.K., Germany and the U.S.A. was compared with 1931-32.

The balance of trade in merchandise had been falling heavily and continuously, the amount of favourable balance in India's favour in 1932-33 being reduced to a little more than 3 crores. But as the excess of exports over imports declined, the net exports of treasure, chiefly gold, increased.

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The most important and probably the most far-reaching effect of linking the rupee to sterling was the export of gold from India in enormous quantities.\textsuperscript{1} The government did not interfere with the export of gold for more reasons than one. Gold exports strengthened the exchange rate which consequently showed a tendency to rise above 1s6d. At a time when the export of merchandise had fallen, and the balance of trade had shrunk very greatly, the gold export created large balance of trade in favour of India.\textsuperscript{2}

The exchange left to itself might have risen in response to the stimulus of gold exports. A 'free exchange' would have been a rising exchanging and through it would have checked gold exports, it might have completely disorganised trade.\textsuperscript{3} The only other alternative, the FICCI strongly suggested, was to have linked the rupee to gold.

\begin{enumerate}
\item K.T. Shah, \textit{op.cit.}, \textit{Sixty Years of Indian Finance}, pp. 532-63.
\item The strength of the exchange led to a surprising situation described by B.R. Shenoy, who claimed that exchange was weak for a few brief months after the divorce from gold, only because of a widespread campaign by the currency league for the 1s6d rupee. The extensive forward purchases led banks to become unwilling sellers of sterling; however after government reassured the market about 1s6d exchange improved and was firm from December 28, 1931 and remained above par ever since.
\end{enumerate}

B.R. Shenoy, \textit{op.cit.}, loc.cit, p. 260.

For all intent and purpose the rupee with gold exports was actually undervalued. The persistent attack on the rupee as overvalued, was because commercial interests claimed that without gold exports, the value would have automatically dropped.
at a low rate, thus to have raised the rupee price of gold higher than its sterling price, and made the export of gold unprofitable. The government could then have purchased gold in the market at that price and sold part of it to pay off its sterling debts and to meet other obligations.

Sir George Schuster believed that gold was only sold to tide over a period of exceptional difficulty and the government was not justified in interfering with the people's right to sell gold and reap the benefit of a high price. Further, the export of gold strengthened the rupee sterling exchange and stimulated Indian exports by raising the purchasing power of countries importing gold, and also encouraged imports into India by enabling sellers of gold to purchase imported commodities. The


"Why therefore should the people of India be deprived of the right to exercise their own judgment in this matter and sell their gold."

Ibid.


Also proceedings of the 5th Annual General Meeting, FICCI Resolution on Gold moved by N.R. Sarkar.

Government of India was clearly promoting an argument for internal security in terms of prices and exchange, bought at a cost of converting gold 'a dead asset' into interest bearing securities in London.¹

At a cabinet meeting on June 22, 1931,


The Finance Member made a detailed reference to the export of gold, and justified it on the grounds that since India required a certain flow of exports to balance her imports of merchandise and external payments, it was in those calamitous times that India should draw upon her resources to equalise the payments position. There was great profit on gold exports because:

"We are free from hampering measures of exchange control; exchange is strong; our credit improved; we have reduced our external obligations and strengthened our reserves, thereby saving the taxpayer interest charges, and improving the chances for raising fresh capital when this is needed for the development of the country; the bank rate has come down from 8 per cent to 6 per cent and as a result all those who are engaged in trade and industry have obtained great relief; while as another result, government securities are rising, a fact which in its turn is improving the position of all banks and investors. If anyone fails to see the benefit to the public in all these signs he must be blind indeed."

Wedgwood Benn warned of 'an agrarian revolt', if matters were allowed to drift. Both McDonald and Wedgwood Benn were convinced that the only way to settle the Indian question was to unalterably fix the value of the rupee at 1s6d; and the Secretary to State insisted that all other considerations must be subordinated to the price objective of maintaining the established currency standard. Any substantial devaluation of the rupee or its divorce from sterling would have enabled India to retain her gold and this could not possibly have been allowed as it would have aggravated the liquidity problem in London which had become acute. Eversince the collapse of the 'Credit-Stalt' Bank in Vienna in the middle of May 1931, the Bank of England was forced with a severe strain on its liquid resources.


2. In the middle of 1931 Germany owed the world £370 million on short term account which created a very serious demand for liquidity in London financial circles. See, Henry Strakosch, Report of a meeting for the discussion on Indian Financial Questions held at the India Office, London October 6, 1931, P.T.Mss 113, pp.4-5.

3. The Indian Chamber of Commerce was particularly critical of the GOI's gold policy.

"The Indian Commercial community is very aggrieved to find that while the idea of conserving gold resources of India was uncermoniously rejected by India Office experts, the same course is now being adopted by the Bank of England.... Both the courses which the commercial community suggested for remedying the situation viz., a depreciation in the value of the currency and a conservation of gold resources, have been adopted in England by the British Government and were yet discarded so far as India was concerned, under the dictation of the same government."

Letter from M.P. Gandhi, Secretary ICC, Calcutta to the Finance Secretary, GOI dated July 4, 1932.

Government of India's unwillingness to liquidate the London held gold securities, coupled with the anxiety to maintain and strengthen the exchange, left it with no other alternative except to export gold against a very determined protest by Indian commercial opinion.

**Commercial Protest**

Indian commercial and public opinion was opposed to the unrestricted outflow of gold. The main grounds on which government policy was criticised were the following:

(a) The government had been parting with an appreciating commodity, gold, for a depreciating commodity, i.e. sterling, and the loss incurred was far in excess of any interest that might have been earned on sterling securities.

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Report of the IMC for the year 1935, pp.39-40. Speech of the President Manu Subedar, Para 1, on 'Gold Exports'.


Letter to the Secretary to the GOI, Reforms Dept., from G.I. Patel AMOA, February 4, 1935.


(b) If the government had brought the gold after selling a part of it to meet its sterling obligations, retained the rest, they could have used it later to strengthen the banking resources of the country.¹

(c) Most important, commercial opinion claimed that gold exports had thrown a veil over the seriously shrinking balance of trade and prevented an evaluation of the alarming deterioration in the country's position as an agricultural producer.²

1. Indian Chamber of Commerce and the Indian Merchants Chamber believed that:

"The government also missed another opportunity of doing justice to India by conserving gold for the eventual establishment of the Reserve Bank."

Representatives of the FICCI laid great emphasis on leaving the rupee alone and on conserving gold resources by purchasing gold at current market rates. This was in London in October 1931 at the RTC in the India Office. P.T. Mss 113, pp. 22-23.

2. The dominant attitude was that the gold sold could never be brought back because of the increasing price of Bullion. Brij Narain claimed that unless the relation between prices of primary products and manufactured goods was reversed the buying of gold would be costly for India and a full-fledged gold bullion standard would be that much more difficult to acquire.

"We exported wheat worth 17 crores in 1924-25. In the first place no one wants our wheat now. In the second place on account of the lower price of wheat much greater quantities of wheat will have to be given to acquire a given amount of gold. The terms of foreign trade have moved against us, thus increasing the cost of gold in terms of food stuffs and raw materials."

Brij Narain 'India in the Crisis'.
Owing to the distress caused by the heavy fall in agricultural prices during 1930-31, and probably intensified by the 1s6d ratio, gold had begun to be sold by the people in rural areas much before England went off the gold standard. M. L. Darling, the Registrar of Co-operative Societies, Punjab, who undertook a tour of the Punjab villages in December, January 1930-31, found gold being sold to meet government dues.1

There was no doubt that the situation was serious. The fall in prices which commenced towards the end of 1929 was particularly heavy in the case of agricultural commodities. As India produced and exported largely foodstuffs and raw materials, the depression made a deeper mark on its economic life than on that of industrially advanced countries. The prices of both Indian exports and imports fell from 1929 onwards, but the fall was much heavier in those of exports. As the exports consisted mostly of manufactured goods, the real terms of trade turned against India.2 In other words, the unequal fall in the prices of agricultural and non-agricultural goods left India worse off


2. "It appears, therefore, that compared with the U.S.A. the Indian agriculturist, so far as his share in the manufactured products is concerned, was in a worse position up to 1931 and was relatively worse hit by the depression than his American brother."

inasmuch as a larger quantity of exports was needed to get the same quantity of imports in exchange.

Both the Calcutta and Bombay index numbers showed a decline. In the following chart, the prices dipped to a low in 1932-33, recovered very slowly to the latter half of 1937 after which prices once again fell or remained steady till late 1939: 1

<table>
<thead>
<tr>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1930</td>
</tr>
<tr>
<td>1931</td>
</tr>
<tr>
<td>1932</td>
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<tr>
<td>1933</td>
</tr>
<tr>
<td>1934</td>
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<td>1935</td>
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<td>1936</td>
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<tr>
<td>1937</td>
</tr>
<tr>
<td>1938</td>
</tr>
<tr>
<td>1939</td>
</tr>
</tbody>
</table>

1. SOURCE: Index number of prices in India General Index for 39 Articles (Unweighted) (1873=100). Department of Commercial Intelligence and Statistics, India, 3rd Issue, Index Number of Indian Prices.
The agriculturist, who formed the bulk of Indian population, was in acute distress on account of the fall in prices up to 1932-33, according to the Review of the Trade of India.\(^1\)

"When the upward movement started in 1932-33, the rise in the prices of commodities in which he (Indian agriculturist) was interested was painfully slow and halting."

Throughout the 30's, the agriculturist was an important issue. Commercial opinion demanded measures to increase the productivity of the primary producer so as to extend the internal market and contribute to the increased production of industrial goods.\(^2\) The Bombay Millowners

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1. See, Vakil & Muranjan, 'Currency and Prices in India' for an account of currency and prices 1920-27.
   Also, Brij Narain, 'India Before and Since the Crisis', pp.470-72.

2. For reasons of internal security, well being as well as the revenue position of the government, the collapse in prices was anxiously watched by the government, as its influence on the agriculturist was extremely damaging. The government, however, contended that hope lay in imperial economic unity; the Ottawa Economic Conference would make a positive advance towards better relations of trade and commerce. The Indian industrialist claimed that government should first put its house in order. Exchange and currency policy was in need of a drastic reform.

See, speech by Finance Member introducing budget proposals for 1933-34, an extract from the proceedings of a meeting of the Legislative Council held in Delhi on February 28, 1933. This was an oft repeated plea.

.../contd.
Association recognised that the condition of trade and industry was not entirely dependent upon the available supply of finance and credit for the construction of textile mills.\(^1\) Severe underdevelopment had crippled the productivity of the primary producer whose consequent lack of purchasing power restricted the consumption of cotton piecegoods.\(^2\) Millowners Associations both in Bombay and in Ahmedabad argued persuasively for devaluation of the rupee, because agriculturists' profits would amplify the stagnant internal

\[\text{(footnote contd...)}\]

"The producer is thus short of money to purchase his necessaries and comforts. This reduction of his purchasing power in turn effects trade and industry. Because goods cannot be sold in sufficient quantities there, stocks accumulate and prices are further reduced."

See Speech of the retiring President Mathradas Vissanji.


market, and the consumption of textiles would increase. According to figures published by the Bombay Millowners Association, the consumption of piecegoods had not increased between 1930 and 1936, contributing to a depression among Bombay mills and the cancellation of the second shift for many years.  

Manu Subedar, in 1933, isolated the primary producer as the most important single factor upon which depended the prosperity of trade. The government's inability or unwillingness to raise the prices of agricultural produce, he said, should be deplored. A number of spokesmen in

There were even the occasional spokesmen in England who saw that the higher ratio would reduce the earnings of the ryot and so restrict the consumption of English industrial goods. This was an uncommon argument, but interesting because it reflected a certain impatience with Whitehall's pre-occupation with the monetary advantages of a higher ratio. The Labour M.P's query was whether this monetary advantage had been bought at the cost of Britain's industrial interest in India's home market. As reported in the Times of India:

"We may also consider the cultivators position from the viewpoint of the British manufacturer. One of the most trenchant speakers in the House of Commons on the India Office vote in July was a labour member. He contended that if the spending power of the Indian ryot could be increased by 2d per month the result would be so good for British trade that all unemployment in Great Britain would come to an end... hence the argument that British interests stand to reap any benefit from 18d exchange if it reduces the wealth of the Indian authority will not hold any water."

Times of India, November 15, 1926, 'The 1s4d Propaganda'


their evidence to the Indian Tariff Board, recorded the fall in purchasing power of the ryot and the harmful effect this was having on the sale of cotton piecegoods in the market.¹ Purshotamdas directly attributed the fall in the agriculturists' earnings to the increased value of the rupee which subtracted 12.5 per cent of his earnings. He believed that the process of adjustment² would take a long time primarily because of the depression and the devaluation of currencies in a number of countries would throw the artificially pegged Indian rupee into a disadvantage.³

1. "My Committee would feel sure, however, that if the present depression were to continue, the agriculturist having no other resources to draw upon; would naturally effect a cut in his expenditure on piecegoods and that there would be a decrease in the amount to be spent on the purchase of piecegoods."

From M.P. Gandhi Secretary ICC Calcutta to the Secretary of the Indian Tariff Board in a letter dated May 16, 1932. Report of the ICC for the year 1932, p.11, Appx.II.


3. A typical extract from the evidence volumes of the Tariff Board 1934 attributed the depression in Indian industry to:

"...exchange manipulation and deflation of the currency has been repeatedly attempted, the money market has been made light, and the purchasing power of the ryot reduced. The position has been made worse by the competition of countries whose currencies had seriously depreciated because it enabled such countries for the time being to continually cut down their prices and place their goods on the Indian Market."

In addition to this, the capitalist class or at least the textile industrialists, did understand the need for agricultural credit to free the primary producer from recurring debt to increase his productivity.¹ Such demands were a direct reflection of the mill owners concern that any decrease in the aggregate earnings of 70-75 per cent of the population did materially harm the ability of the home market to absorb industrial goods especially textiles.

The Over Valued Rupee

The debate over the 1s6d rupee grew bitter with the severe prolonged depression of the thirties. With countries devaluing their currencies, an overvalued currency like that of the rupee, in spite of sterling

1. The ICC Calcutta probably among the most articulate and far seeing chambers (no doubt under the able guidance of G.D. Birla) suggested to the Indian Central Banking Enquiry Commission that Banking must create conditions of prosperity amongst the agriculturist.

"In February last, Sir Frederick Sykes, the Governor of Bombay remarked, while addressing the Bombay merchants, that in that 500 crores are being lost to India annually through the failure to take full advantage of the productive possibilities of the soil. Unless therefore government of the country directs its energies towards improving the productivity both in the sphere of agriculture and industry thereby enabling people to save something there cannot be much improvement in the development of Banking."

going off the gold standard, stood at disadvantage in terms of the rupee value of exports. To some extent, the worldwide demand for Indian goods can be measured by a rough comparison of wholesale price indexes of various countries. The table on the next page shows the movement of prices in India and certain other countries.1

It was possible that the disparity between the price level in India and abroad was due to (1) heavier fall in agricultural prices and their halting upward movement, and (ii) rearmament programmes of several countries which led a spurt in prices. Any persistent failure of Indian prices to catch up to world prices would, however, have to be attributed to the rupee2 (specially at a time when countries were devaluing their currencies because of world wide depression). Even if it could be established that this failure was not due to the 1s6d ratio, there still remained a case for devaluing the rupee to initiate a rise in prices.


2. The Federation complained that the over-valued rupee allowed depreciated currencies to dump their export goods in the Indian market; questions relating to Indo-Japanese trade relations occupied a good deal of attention of the Federation in 1933-34. Early in June 1933, the President of FICCI Nalini Ranjan Sarkar issued statement to the Press regarding the strained relation between India and Japan owing to "India's high tariff walls against imports from Japan and Japan's dumping of her manufactured goods through the depreciation of her currency."

See, FICCI Silver Jubilee Souvenir, p.75.
## INDEX NUMBER OF PRICES (1929 = 100)

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**SOURCE:** D.K. Malhotra, *History and Problems of Indian Currency*, p.106.
Had such a devaluation been possible, it could be argued that this would have stimulated Indian Industrial production. Imported commodities would rise in value giving added protection to the home market. Exported commodities would drop in price catalysing demand, but not necessarily unburdening the agriculturist. It would appear that no lasting increase in Indian exports could be secured without a general revival of world demand for them; though admittedly deflation in India had made India's troubles worse, and had been magnified by savage contraction, this was not a simple translation of this or that ratio.

1. A further question would then have to be asked, which class of agriculturist, where in the country, and so on. Higher prices would mean substantial benefits to the mill owners, rather than the peasant. Because those who would eventually benefit from larger profits would be able to buy either the same amount of cloth at a higher price or a greater amount of mill made material.

2. This was the plea of the Finance Member, who to divert attention from the over-valued rupee, claimed that the depression in India was a simple reflection of depression in world trade. As a result, India's ills could be cured by a greater international cooperation on the exchange of commodities. Schuster said of the year 1932-33 that monsoons had been normal and that economic conditions in India would have been prosperous.

"Again as last year, I can say that world economic conditions have been the over-riding factor, and that India's trade and purchasing power have been suffering from the terribly low levels to which prices and demand for commodities have declined."

Speech by Finance Member on introducing the budget proposals for 1933-34 in a meeting of the Legislative Council held in New Delhi on February 20, 1933, loc.cit.
Official Concern

Despite the unwillingness of the Government of India to consider monetary devaluation, the prolonged depression of the 1930's seriously worried British-Indian officials. With the beginning of the series of Indian Tariff Board enquiries in 1927, the Government of India appeared increasingly to grant substantial concessions, if not in monetary policy, then in fiscal autonomy, to at least partially satisfy the Indian demand for protection of the home market. Throughout the 1930's, the Indian Tariff Board conveyed and considered the problems of a number of industries, widening the scope of duties on foreign imports, and preserving domestic industry, especially textiles, from economic ruin. There is little doubt that there was increasing concern both in India among the Viceroy and his officials and in London over the rapidly deteriorating political condition of the country. The Civil Disobedience Movement had threatened a potentially dangerous unrest, and with the worldwide depression,¹ growing from bad to worse, this threat had to

1. There were plans to set up an Economic Advisory Committee which demonstrated a sincere intention on the part of some officials in the GOI to initiate a dialogue with the commercial community and allow some participation in the formulation of commercial and industrial policy.

See, 'Notes on Economic Policy' a file prepared on the proposed Economic Advisory Committee by the Commerce Dept., GOI Fin. Dept., File 15-1-F/1930 and 15-1-F/1931, NAI.
be stemmed by some real effort at reinvigorating the
economy. ¹

The effort, as it was carried out, met with strong
disapproval from Lancashire textile interests, whose
exports threatened by Indian cotton duties led to a
serious reduction of Lancashire's share of the Indian

1. To some extent this was suggested by the Indian
Industrial Commission in 1918.

"We feel sure that the strongest support will be
forthcoming from the public generally and from
Indian capitalists and industrialists in particular
to any well considered scheme for industrial progress
which government may see fit to adopt..."


Whether the hope actually was articulated is not as
relevant as the fact that government was prepared to
appoint the Tariff Boards as a sign of an increased
concern about the growing industrial community. If
there was no well knit plan to encourage industry,
GOI thought it fit not to go entirely against Indian
industrial interests, if only to secure short term
advantages of less obstruction in the Assembly and
specially at a time when the entire country was
involved in Civil Disobedience.

See, the Exchange of letters over the proposed
cotton excise duty of 1930, between Wedgewood Benn
and Lord Irwin. Reel 2 and 3, Halifax collection,
March to September 1930 over 4 per cent increase in
cotton duties.
piecegoods market.¹ When in February 1930, Wedgewood Benn wanted, at the Viceroy's request, to approve the raising of Indian cotton duties from 11 per cent to 15 per cent, he was strongly opposed by the Cotton Union leader, Tom Shaw and by Phillip Snowden.² Manchester and Lancashire spokesmen strongly urged that complete fiscal autonomy should not be granted by the Round Table Conference to India and whatever was given should be

1. There was tremendous pressure on the then Secretary of State, Wedgewood Benn to grant some concession to Lancashire cotton interest by opening up and increasing the opportunities of trade with India.

"The industry has been struggling for years on account of bad trade owing to the Indian importers for at least two or three years.... Deputation was led by Mr. Campbell to impress upon me that the Lancashire Cotton Trade needed some assistance in removing obstacles in its trade with India."

Letter from Secretary of State to Halifax, March 20, 1930. Halifax collection; over 4 per cent increase in cotton duties, op. cit., loc. cit.

See also, Irwin's plea, that he had been trying his best for the Manchester and Lancashire men, but the strength of feeling was so virulent that it was difficult for either Rainy (Commerce Member or Schuster Finance Member) to go against the feelings of the Indians at this critical juncture.

Letter to Secretary of State from Viceroy Irwin, September 5, 1930, Halifax collection, op. cit., loc. cit.

subject to rights of veto in the interests of United Kingdom trade. In spite of this protest neither the Viceroy nor the Prime Minister, Ramsay MacDonald, would agree to Philip Snowden's request that the proposals for limited fiscal autonomy be modified.

In spite of this sympathetic interest shown towards the Indian delegates demand at the Round Table Conference for Fiscal autonomy it was quite clear that there were to be no concessions, real or apparent on the management of monetary policy.

1. Ibid, p.219

2. Birla alleged that in 1931, if the rupee was allowed to float it would have dropped to a level that would be close to 6p or 7p to a rupee. The enormous cost in maintaining an artificially valued rupee was responsible for India's slender gold resources.

"A lot of gold was dissipated in maintaining the exchange rate at ls6d gold, with the result that slender before, they have become much more slender. In the PCR... about 4 to 5 years ago, the gold resources amounted to 68 crores of rupees. Today I think only 4 to 5 crores of rupees are left."

G.D. Birla: Report of a meeting for the discussion of Indian Financial Question held at India Office, October 6, 1931, pp.19-20, loc. cit., op. cit.
Parthasarthy Gupta remarks that this attitude was:  

"... more out of ignorance than out of a plan to exploit India for the parasitic (British) working class."  

As Gupta's own material shows, this was not entirely accurate. From arguments set forth by Indian officials, which Mr. Gupta has referred to, it becomes naggingly clear that by devaluing the rupee the Government

1. Montagu Norman, the then Governor of the Bank of England was not at all anxious to allow the surrender of financial responsibility to the proposed Reserve Bank which would handle the management of currency and exchange. Norman insisted that if such a Bank be granted it should be:

"A. Necessity of what is called the marriage of that Reserve Bank to the Bank of England.

B. Connection of the Bank of England to the Reserve Bank in every respect short of statutory control.

Montague Norman warned that the -

C. Change of control of India (financial responsibility) from Whitehall to Delhi, whenever it takes place, cannot help making for dire result to the credit of India."  

Summary of an interview with Montague Norman by 7 members of an Indian Delegation to the 3rd RTC, December 15, 1933, P.T.Mss 133, p.96.

2. Ibid., p.223.
of India might fail to meet the sterling liability of the Indian Government's debt and the pensions and provident funds of past and present European officials. A larger consideration was the priority attached to the maintenance of stability in the remittance of surplus for maintaining the British controlled gold standard and the monetary apparatus of the Empire, both of which would have been disturbed by any radical monetary reform.  

Hence, the interests of individual industries in Great Britain or of British industrialists' were sacrificed for the priority of 'Empire'.

1. The official explanation for India's monetary responsibility to the rest of the world was because of India's substantial foreign assets and as a debtor country her large obligations in sterling both governmental and private made the obligation of exchange a vital, important priority.

"India's financial relations with foreign countries is very intimate and very substantial. India's prosperity very largely depends upon a steady stream of loan funds finding their way into India."

The pressure would not have been as intense, added Stratosch if India's masses could save in 'Economic Values' rather than in precious metals.


The Industrial Interest

With the political initiative firmly in their hands the Government of India were in a position to exercise effective supervision of monetary policy in spite of vigorous and repeated petitions from Chambers of Commerce and industrial associations.

The Indian capitalist class, during the inter-war period, was a nascent weak bourgeoisie whose existence and growth depended upon the active encouragement of the Government of India. It is not surprising to find that among the reports submitted by the Indian Tariff Board for an entire range of industries only textile and, to some extent, steel stand out as articulate spokesmen for protection, monetary reform and so on.¹ The paper pulp, sugar, engineering, cement industries grew just before or just after the First World War, and in none of their petitions to the Indian Tariff Board, did any form of economic thinking, beyond the dimension of their separate concerns, emerge. It is, therefore, not surprising that even after the 1930's the capitalist class caught between

¹ The Indian Tariff Board also sat to review protection for the sugar industry, paper pulp, engineering, cement and so on.
a still powerful Imperial Government and a popular political upsurge, remained a heterogeneous collection of employers of labour rather than a powerful effective political pressure group.¹

During the committee stage of the Reserve Bank Bill, the Chairman of the Indian Merchants Chamber recorded that an eminent patriot like P.C. Ray had lent himself toward the narrow provincial view that a lower exchange rate would benefit only Bombay.² It was recorded

1. Dr. S.B. Sabade and Namjoshi, though in an allegation of fact rather than criticism, said:

"Throughout this period (1905-1947), however, the organisation of chambers of commerce continued, in the main, to reflect the separate organisation of nationalities (British and Indian), as also a community-wise base, a regionwise base and a language base."

Dr. B.R. Sabade and Dr. M.V. Namjoshi, Chamber of Commerce and Trade Associations in India, p.41.

2. Namjoshi is convinced that the Indian Merchants Chamber was one of the most committed chambers to the cause of nationalism. During the years 1930 to 1932, IMC dealt with issues such as internment of Gandhi, imprisonment of Motilal Nehru, Marshal Law in Sholapur; it took a stand by withdrawing its representatives from Central and Provincial Legislatures, and went to the point where government thought it might be contingent to declare the chamber unlawful. It was only later that FICCI grew more prominent.

See, Sabade and Namjoshi, op.cit., p.51.
that fortunately Dr. Tagore, Dr. Bidhan Chandra Roy, and Nalini Ranjan Sarkar intervened saying:

"Our forces for the development of trade and industry are naturally weak because of the existence of foreign rule and we are but helping the reactionary tendencies against us if we do not all pull in the same direction but different ways." ¹

There did exist a discernible tension between the growing industrial centres of Ahmedabad and Bombay, and Calcutta - the most important outlet for British enterprise in extraction and plantation industry.² The


2. Though Stanley Kochanek has exaggerated the influence of the regional origin of business groups on the eventual articulation of an industrial interest, there is little doubt that during the inter-war period there were differences that were serious. Kochanek says:

"Substantial differences, based on the uneven commercial and industrial development of various regions, tended to overlap between caste and community boundaries and to intensify the divergence between Calcutta and Bombay."

Though I would agree with the consequences of uneven development, I would not entirely agree that as late as 1930-32, caste and community had a large influence on chambers within the two cities of Bombay and Calcutta. Differences were generated by genuine and often irreconciliable attitudes to political organisation often motivated by commanding figures, like Purshotamdas and Birla. Caste and community feelings certainly did exist, but they operated in deep background and never determined coalitions or groups.

conflict between Indian businessmen and their counterparts in Eastern India could have occurred on two grounds:

(a) Indian businessmen and entrepreneurs increasingly moving into the vacuum created by the gradual contraction of British controlled enterprise, had a greater stake in export-oriented monopolies of jute, tea, coal, iron ore and so on. The higher exchange would have hit them, but not as hard as the Bombay or Ahmedabad millowners whose cotton piecegoods faced with bitter hostile competition, would have been priced out of the world market. More important, the Bombay and Ahmedabad Millowners' first concern was the home market, unlike the Calcutta industry and the problem of exchange would have been urgent. When the Government of India allowed representation to the Board of Directors to take place on the basis of Chambers of Commerce, this would have stimulated the tension between the Calcutta and the Western Indian businessmen, particularly over the exchange ratio.¹

(b) The West Indian businessmen had a great stake in the huge cloth markets of Bengal. In his evidence to the 1936 Tariff Board, the spokesman of the Bombay Millowners Association² stated that on certain varieties of cloth,

¹. See below, my own chapter on the 'Exchange Agitation and the Reserve Bank Bill'. The reason for the differing attitudes on the 1s6d rupee is explained in detail.

². 1936 Special Tariff Board for the Cotton Textile Industry. See, Evidence of the BMOA and the AMOA, Vol. II.
Bengal was the greatest buyer owing to the absence of a sufficiently developed textile mill industry in Bengal itself. Both Bombay and Ahmedabad were very hostile to any idea of a textile industry developing in Bengal as it would mean the end of a profitable market for their own piecegoods.

These scarcely visible tensions, contributed towards commercial opinion in India being unable to function as a powerful united pressure group. There remains a persistent impression that the protection actually granted by government appointed Tariff Boards, was given entirely on the initiative of the Government of India however limited or handicapped this initiative actually was.¹ Hooseinbhoy Laljee complained that the unresponsive character of the government revealed by its indifference to the exchange agitation had convinced some leaders in direct political action. Laljee's speech

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¹ Hooseinbhoy Laljee said:

"I admit that the unresponsive character of government had led many minds, perhaps some of the most brilliant we have got, and some personalities, some of the most patriotic and self-sacrificing we have got to believe no longer in the method of political agitation, which Lokmanya Tilak styled as 'responsive Cooperation' and to start a method known as 'direct action'.

Hooseinbhoy Laljee retiring President of the IMC 23rd Annual General Meeting, 1930.
Report of the IMC for the year 1930, pp.36-37.
nevertheless was cautious. He disagreed with Schuster that the world depression and the low prices offered for India's cotton was because of extremely difficult conditions created by the political situation in Bombay and reiterated the persistent indifference of the government towards industrial progress. There were only one or two careful allusions to the Civil Disobedience Movement, but nowhere was the Congress campaign used as a threat to extract industrial reforms.

With the deepening crisis commercial opinion towards the government and the inflated rupee began to harden. Manu Subedar as late as 1934, stated that the political interests of the government of India were other than for the economic and industrial benefit of India. He accused the government of dividing public

1. Ibid., pp.7-8.

2. Laljee ended his speech with the hope that the visit of Arthur Salter, a financial expert would convince the government of the need to encourage industry. He said:

"We are close to getting all we want. My request is that we stand together united."

The extract dated 1930 from a speech by Laljee appeared optimistic in comparison to BMOA, AMOA and FICCI Reports.

opinion to allow the government to transform India into a free market for the sale and profit of manufactured goods from the U.K. The system of Imperial preference as typified by the Ottawa Agreement had not even in its limited sphere of reference, brought any gain to the exports of raw cotton and produce from India. On the contrary, it was clear, he stated, that the British imports into India had been appreciably stimulated by the preference. Though the

1. B.N. Adarkar specifically condemned a pamphlet issued by FICCI on the Ottawa Agreement saying that there was little doubt that the Agreement did strengthen the forces of Empire trade, and help towards a greater offtake of our own produce in terms of not only raw cotton and jute but other commodities consumed by the Empire countries as well. He accuses the FICCI pamphlet of misrepresenting facts, and deliberately creating an incorrect impression based on propaganda and not on scientific inquiry.

"Never before has a commercial transaction been the subject of a more mordant criticism in this country than the Ottawa Agreement. Much of the criticism has been uninformed and unscientific and has consisted of such clap-traps as, for example, the assertion made by many a speaker on the Assembly Floor that the Ottawa Agreement caused a loss of 20 crores to us."


2. See, Report of the FICCI for the year 1934,1935, 1936. The volume on the Executive Committee's decisions is a valuable guide to Part II.

See also, BM0A Annual Report for the year 1935, President: Sir Joseph Kay, President's Speech, Section I, pp.ii-x.
auxiliary agreement with Japan did bring some immediate relief to the Indian cotton grower, this could at best be only temporary.¹ The real interests of the cotton producer could only be served by the adoption of a policy of national self-sufficiency in regard to utilisation of local industry of raw cotton produced within the country itself.² It was still clear

1. Negotiations for the conclusion of a new Indo-Japanese Trade Agreement in July 1936. The Federation recommended that a trade treaty should be concluded on a strictly reciprocal basis. The concern was expressed over the entire spectrum of the commercial contact between Japan and India, desiring a more limited role for Japanese trade.

See, FICCI Silver Jubilee Souvenir, 1927-51, p.36. Industrial interest were particularly critical of the increasing penetration of Japanese produce because of the enormous exchange bounty that the Japanese took advantage of. In 1932, duty on Japanese goods was raised to 50 per cent ad valorem, but by the time the legislation was enacted, exchange had risen further and neutralised the import duty. In 1933, import duty was raised to 75 per cent ad valorem, and the Japanese retaliated by declaring a boycott of the purchase of Indian cotton. The Indo-Japanese Trade Agreement, which emerged in January 1934 was on a quota system that restricted imports to 400 m.yds. against the purchase of 1½ million bales of cotton.


2. FICCI proceedings of the 10th Annual General Meeting for the year 1936-37. President Devi Prasad Khaitan, Report of the FICCI for the year 1936-37, pp.4-17.
that the persistent demand of Chambers of Commerce
for a more rational industrial policy had in no way
shaken the political authority of government.

The 1934 Indian Merchants Chamber Report
complained that the attitude of the government to the
exchange problem demonstrated that:

"The object underlying it is obviously not to
allay fears and suspicions of Indians, nor to
assure them that the pledges given to them would
be ratified in the near future, but to allay the
fears and suspicions of the British people and
to assure them that the transfer of real political
power was not to be effected... and that the grip
of the British Government over India was not to be
loosened as yet." 1

This relatively critical attack on government's
policy was typical of many of the statements issued by
Associations and Chambers of Commerce between 1930-35.
Petitions, letters and representations to the Government
of India and the Indian Tariff Board grew numerous and
were submitted from every section of the capitalist
class. Resolutions on anti-dumping, Japanese competition,
Lancashire Trade, government attitudes towards labour and
reform, illustrated a serious dissatisfaction with
financial policy. Tempers ran so high that the Bombay

1. Manu Subedar, President of the IMC 1934.
   See, Report of the IMC for the year 1934,
   pp.1-8.
Millowners Association and H.P. Mody were accused by Birla, the Federation and the Ahmedabad Millowners Association, of a sell out to British interests when the Bombay Millowners Association signed an agreement with a Lancashire delegation that later became the model for Tariff Policy of the Government of India towards United Kingdom piecegoods imports.\(^1\) The Indo-Lancashire Textile Trade Agreement or the Lees-Mody Pact was not a great departure from earlier policies on protection of tariff duty rates. Mody defended the agreement, saying that barring a few concessions in the matter of yarns and artificial silk piecegoods, which none of the more important associations had criticised,

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1. FICCI was very critical of the Pact. A summary of their disagreement states:

"In February 1934, the Committee protested against the action of the GOI in fixing the Indian Tariff Amendment Bill, this gave effect to the Bombay-Lancashire Textile Agreement, a lower rate of duty on imports from Lancashire than that unanimously recommended by the Indian Tariff Board."

*FICCI Silver Jubilee Souvenir*, p.75.

Neither was the Congress Party very happy with the BMOA deal with Lancashire. While opening an All India Swadeshi Exhibition, Jawaharlal Nehru was reported to have said that he did not approve of the Agreement of the Bombay Millowners with Lancashire.


*Bombay Agreement: The Exhibition was in Allahabad*. Also, November 12, 1933, Bombay Millowners in Limelight, p.5.
the only concession that the agreement made was in
the matter of cotton piecegoods. The agreement stated
that:

"... If and when the revenue position of the
country made it possible for the Government
of India to remove the general surcharge on
all imports imposed in October 1931, the Indian
side would not make fresh proposals with regard
to the duties applicable to United Kingdom Imports."¹

The earliest date on which Lancashire could
possibly obtain relief under this clause might have
been by March 1935. Mody explained that as the general
agreement would expire in 1935 after it
was impossible to imagine any material injury to textile
interests taking place.² In return, Lancashire had
promised to use a large amount of Indian cotton, and

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1. See, Dr. Basudev Chatterji's recent work on
Indo-Lancashire in which the Mody-Lees Pact op. cit.
has been exhaustively analysed. For ref. see
Report of the BMQA for the year 1933. App. pp.311-12
2. According to B.N. Adarkar, H.P. Mody was quite
correct:

"Exports of raw cotton have increased from
423,000 tons in 1931-32 to 626,000 tons in
1934-35 and those of Jute Manufactures have
varied between Rs.21 and Rs.22 crores during the
last four years."


See also, H.P. Mody's defence of the Indo-Lancashire
Trade agreement as Chairman of the BMQA for the
year 1934. Section I proceedings of the Annual
General Meeting, pp.ii-iii.

Report of the BMQA for the year 1933, May 23, 1934.
Bombay Millowners Association reported that twice the quantity of Indian cotton had been used compared to a corresponding period the previous year. However, in spite of Mody's attempt to explain the agreement, the Ahmedabad Millowners Association complained that Mody had inhibited the demand for protection against the United Kingdom. The Federation believed that the agreement had set a precedent against complete fiscal autonomy that was India's right.

In October 1936, the ratio had figured in the Legislative Assembly and a motion to censor the government on this issue was only lost by the casting vote of the President of the Assembly. The weakening of the exchange rate of the rupee in 1938, promoted once again, the demand for a lowering of the exchange rate. The Working Committee of the Indian National Congress took up the question and sought to bring pressure on the Government of India by directing the Congress Ministries in the provinces to send representations urging upon them the need for an immediate lowering of the rate. ¹

In May 1938, the Conference of the Prime Ministers of

¹. A deputation of the Indian Merchants' Chamber placed the viewpoint of the ICC in regard to the exchange rate before the Viceroy on January 23, 1939.
the Congress governed provinces at Bombay reported to have considered the question and resolved to secure the Central Government the case for a lower rupee sterling ratio.

The government sensed that the fall in the exchange to the lower gold point in June 1938 would provide more ammunition to the agitation for a devalued rupee and promptly issued a communiqué on June 6, 1938, offering their determination to maintain the existing ratio. Purshotamdas Thakurdas, at a meeting of the Central Board of the Bank held in Madras in July 1938, questioned the communiqué asserting that the gold reserves of the Bank were not as strong as the Central Government believed them to be. The ratio would

1. In a communiqué issued again on December 16, 1938, the GOI made it clear that they had no intention of allowing a lowering of the present value of the rupee and that they intended to defend it by every means in their power. The Communiqué added:

"In fact a lowering in the ratio would do no good to anybody except the monied and the speculative interests who profit from conditions of uncertainty and disturbance or secure an additional but unseen all round increase of 12½ per cent of protection afforded to them at the expense of the consumer."

Extract from Brij Narain, 'India Before and After the Crisis', p.466.
lead to a contraction of currency that would effect the Bank rate and the money market seriously handicapping industrial interests within the country. 1

The serious attention which leading industrialists and members of the Central Board of the Reserve Bank gave to the ratio question was part of a wider agitation in the country at large on the subject; it is just possible that there was coordination in the matter. Following the lead given by the Congress Ministry of Bombay, most of the provincial governments made representation to the Government of India regarding their views on the inflated

1. In 1937-38, a recession in prices took place, though the magnitude of the decline was much smaller than in the early 1930's, harvest prices of food crops declined 7 per cent and more or less the same position continued till 1939-40. In other words, recovery between the years 1934 and 1937 was at no stage complete and implied for the mill industry a state of continuous reduction of the output. This promoted a number of Chambers to actively pursue the much talked of ratio question. The Indian Merchants Chamber presented a petition to the Viceroy urging upon him the urgent necessity of revising the 1s6d ratio.

See, Speech by J.C. Setalvad (incoming President), Report of the IMC for the year 1938, pp.iii-iv.

rupee.¹ Memoranda were submitted from leading
Associations and Chambers of Commerce (the Finance
Secretary to the Government of India) C.D. Deshmukh
inspired a detailed well informed tract submitted by
the Government of Central Provinces and Berar. The
issue was raised on the floor of the Legislative Assembly
in August 1938. In September 1938, non-official members
of the Assembly made an unsuccessful attempt to secure
the appointment of a Committee to report on the whole
question of the rupee ratio and to determine a permanent
basis for monetary policy, the Congress Working
Committee passed a resolution urging immediate steps to lower the ratio.²

1. The Punjab Government did not join the eight autonomous
provinces which demanded the fixation at 16d. The
reasons stated were the usual oft repeated official
excuses for an inflated rupee; stability of world
currencies, the devaluation would not stimulate
exports, consumers would be hit, sterling liabilities
would increase and there would be an outbreak of
speculation.
Brij Narain, 'India Before and Since the Crisis', p.467.

2. The reawakening of the ratio controversy occurred in
late 1937, early 1938 when it became apparent that:
"The foreign exchange market turned weak from the
beginning of April 1938 and there was an appreciable
decline in the amount of sterling tendered to the Bank.
The RBI at first tried to stop the rot in the exchange
by effecting a drastic reduction in its acceptance of
the mid month tender to the nominal amount of £10,000
at a rate of 1s6-3/32d and by rejecting in the following
week tenders made at 1s6d."
The Bank suspended purchases. However, the rate continued
to fall and touched statutory low of 1s5-49/64d in the
first week of June 1938. It was this desperate attempt
by the Bank which encouraged Purshotam to reassess his
position on the exchange problem.
See, History of the RBI, 1935-1951, RBI Publication,
Despite the scope and the dogged persistence of the agitation, the government remained adamant. At a meeting of the Central Board of the Reserve Bank in November 1938, there was a general discussion on Purshotamdas Thakurdas's resolution during which the government's representative made it clear that the Governor General was determined to maintain the statutory ratio by every means in his power. Sir Purshotamdas Thakurdas objected to the categorical nature of the government's pronouncement and desired his reaction to the message be conveyed to the government. In reply, the government merely reiterated the statement made by their representative on the Board. It appears that the government even considered the question of superseding the Central Board to prevent 'an increasing element of futility creeping into their relationship with the Board, should this difference of opinion in regard to the vital matter of the ratio persist'.

The Board did not press the matter any further and, by 1939, Sir Purshotamdas Thakurdas and other members of the Board were convinced that the ratio agitation did not apparently command more than a formal

support from the major political party - the Congress.\footnote{1}

The agitation for a lower rupee rate lost most of its force as the exchange steadied by the end of 1939, and withered away with the outbreak of war and a change in the entire balance of payments position.

The most striking feature of the exchange agitation was probably the government's unshakable stand on the pegged rupee. The Government of India, in spite of a persistent agitation and an economic depression of worldwide proportions maintained the 18d rupee from 1926 to the end of 1939. Though substantial concessions were granted to industrial interests, it was quite clear that neither the Viceroy nor the Secretary of State would

\footnote{1. In January 1939, the Central Board of the RBI by a majority of eight to five passed a resolution deploring the attitude of the government and trusting that they would reconsider the situation. The resolution also stated that: 

"If the opinion of the elected members of the Board is set aside in this manner by the Government of India, the very purpose and motives of starting the RBI is to a considerable extent discounted." 

The Board did not press the matter any further, recognising as C.D. Deshmukh suggests that the agitation was not as powerful or widespread to have been able to force the issue with government. 

See, \textit{History of the RBI, op. cit.}, p.175. 

See also, C.D. Deshmukh, 'Central Banking in India', a Retrospect, Address delivered at the Gokhale Institute of Politics and Economics.}
surrender responsibility over monetary policy. There is no doubt that one of the considerations that contributed to this uncompromising attitude was the annual remittances that the Government of India was forced to maintain. Both official remittances in service of debt and civil service pensions, and unofficial remittances of capital were payments that were too important to disturb or radically modify.

The inflated rupee also depressed prices, and taking into account the repeated concern of the Government of India over the urban consumer, it was politically useful to maintain the 18d rupee. The first and second non-cooperation Movements and the Civil Disobedience Movement were initiated at times of severe economic crisis. It is just possible that an artificially pegged rupee could have been politically useful and an additional reason...
for the Government of India's stand on the rupee.¹

The government claimed that there were very substantial monetary reasons as well. The inelasticity of the currency, the duplication of reserves, the primitive nature of banking in an under-developed economy,

1. To maintain the level of prices, amongst the urban middle classes; and by not disturbing their purchasing power which may have quietened the protest against deteriorating conditions. A.C. McWatters in a memorandum said that, (of the 1s4d rupee).

"So far as particular classes of the community are concerned, the effects in the long run are not large except in so far as those on fixed salaries and wages are concerned who may find it difficult in effecting a readjustment comensurate with a higher level of prices."


See also, Evidence by Basil Blackett to the Hilton-Young Commission, Vol.IV, p.8, Para 61 (of the 1s6d rupee).

"On the other hand, it would mean that all those on fixed salaries or those who received customary wages, a great many wage earners, would be better off in terms of real wages."

Admittedly, it is still debatable whether low prices was among the prominent reasons for the GOI's anxiety to maintain the higher rate. Consider however a section of the report of the Babington-Smith Committee which clearly illustrated the government anxiety over the price of essential commodities.

"... Disturbances have actually arisen in various parts of the country from time to time as a result of high prices, and the social and economic discontent to which they give rise is especially serious in a country where the mass of the population is ignorant and uneducated, and inclined to attribute all calamities to the action of government. The rise in prices in India has now reached a point at which it is injurious to the country as a whole, and we believe that any measures tending either to reduce prices or to check a further increase would be beneficial to the mass of the population."

all contributed to making government manipulation of currency and exchange necessary. Unless the Government of India preserved its initiative over monetary policy disturbances would occur in the international position of sterling which could scarcely be permitted.

But the exchange debate had been fought at cross-purposes. Both the government and the business community fired broadsides at each other but neither position could have ever been demolished if the debate continued to be dominated by a fractional revision of the rupee. Admittedly, one of the more serious problems that leading figures in the debate like Purshotamdas, had to face, was the sheer diversity of opinion on monetary reform. The business class was neither a disciplined nor a homogeneous group and did not possess the capacity to present a common front in their confrontation on exchange. Its own uneven development, and the fractured progress of industry during the inter-war period encouraged individual or small groups of businessmen to break away from the pack to demand special official consideration and limited reform. Certainly industry did suffer from enormous constraints of foreign competition, inefficient links with its own markets, official indifference, and what has not yet been explored sufficiently, the monetary chaos of the inter-war years. Unfavourable money conditions made industrial enterprise
in India turn inwards for their credit requirements as a result of which shoddy, obsolete structures such as the Managing Agency system survived. Official manipulation of the rupee was so persistent that the extent of damage caused to industrial activity must have been enormous.

Fluctuating rates of interest, insufficient liquidity, an inefficient apparatus for marketing commodities, an absolute lack of long term finance all of which must have restrained growth and made the day-to-day working of indigenous enterprise that much more difficult.

But what indeed the debate demonstrates is that the ideology of the businessman borrowed from the early nationalists had not grown any more comprehensive.

The capitalist class, and especially the Textile interests in support of a devaluation of the rupee, petitioned the Government of India with a whole range of evidence to show the detailed effect of the 1s6d rupee on the Indian economy. Much of this material gives us today a picture of how the Indian capitalist class envisioned industrial development. Their strongest demand was for state intervention, argued in terms of protection and fiscal autonomy to help Indian industry develop, manufacturing techniques and produce competitively with Japan and Lancashire. Bagchi sees this critically, arguing that such measures may have sufficed when the major competitors of Britain, Russia, France, U.S.A. and Japan were just beginning on the road to industrialization.
Quite rightly so, the industrial ideology of the business community was stunted and unable to go beyond papameterees that had been laid in the late nineteenth century. As our story unfolds first as an analysis of the monetary policy of government and then as an appreciation of the industry's political response, this inadequacy in capitalist ideology will be assessed. For now it would be vital to take a look at what went on behind the sets. The technicalities of currency manipulation were enormously complicated and sometimes imperfectly understood by the clumsy monetary engineers responsible for the system. It formed the background to the political debate, as an invisible machine of government policy that has been brought into sharper focus to illustrate the extent official attention that centered on exchange.