INTRODUCTION

The important role that money plays in economic life has long since been recognised. The role of money has changed and will continue to change with the changing conditions of times. In the early days, its role was passive. It served like a barometer to indicate simply the rise and fall in the exchange value of goods produced through the combined efforts of the different factors of production. But with the passage of time as under the capitalistic economy, new economic problems in relation to production and economic organisation began to crop up, the importance of money as an independent means of influencing the productive activity came to be recognised. In the inter-war, war and post-war periods, money played an important part in influencing the cyclical behaviour of consumption, savings, investment and employment. And in the foreseeable future, whatever may be the type of the economy, capitalistic or socialist, money will continue to play an important part in the organisation of economic activities, because of its importance as "a link between the present and the future," as Keynes puts it.1

The place of money was very insignificant in the orthodox treatment of political economy. The view of the classical economists(2) is that it is the "natural" law of supply and demand which determines the relative values of individual resources and commodities.


2. Whichever a reference is made to classical economists in the discussion, it does not refer to a single economist but a body of economists who have in one way or other, responsible for building up the classical school.
They give emphasis on how a given volume of resources is allocated in production and how the income derived from production is distributed over the different factors of production participating in it. Money, in their opinion, is merely a medium of exchange through which the values of commodities produced are expressed. The possibility that money might adjust the economic operation of supply and demand was beyond the scope of their consideration. That money should be capable of causing any change in economic phenomena or disturbing the functioning of an economy as an independent factor was perhaps not visualised by them. They assume that the value of money is stable. Therefore, in order to explain fluctuations in the value of money and their effects on economic activity, a separate theory of money, in their opinion, is unnecessary. Later on, even when monetary phenomena were recognised as independent variables capable of influencing the economy, they gave still the theory of money a subordinate position to the general theory of value.

Monetary theory which fell into the background in traditional economics, has been given a place of great importance by the modern monetary theorists in the determination of employment and production as a whole. Unlike the classicists who had treated the theory of money separately from the theory of output, monetary theorists like Keynes and others integrated the theory of money into the theory of output and employment. Although Keynes, at first, was much influenced by the traditional monetary theory as is evident from his earlier works, he moved, later on, from the narrower field of monetary theory to the wider field of general economic theory. With the

III.

Publication of his book "The General Theory of Employment, Interest, and Money" in 1936, Monetary Theory as Professor K. K. Kurihara observes, "definitely shifted its centre of gravity from an explanation of the effects of changes in the value of money on the distribution of wealth to an explanation of the effects of changes in aggregate income and expenditure or general economic stability."

Keynes's approach is the income approach. It is the volume of expenditure to which greater importance should be given and not the quantity of money. This should be so because the aggregate expenditures or outlays, whether on private investment or government outlays or both, and also outlays on consumption affect employment, production and income. In other words, the rise in the aggregate outlays expanded on goods and services would normally result in an increase of goods and services and employment. When the decision to spend is made, the supply of money may be increased; that is, the increase in the money supply is not the cause but the consequence of investment activity.

While the quantity theory of money is relegated to the background by Keynes, the role of money is explained by him in relation to the theory of interest. The rate of interest is vital in relation to investment which again is an important determining factor of employment and the theory of interest is at the same time a part of the theory of money.

IV.

As such, the responsibility lies with the monetary authority to regulate the interest rate by controlling the supply of money being one of the methods of controlling output and employment. Thus, it is claimed by the modern monetary theorists that monetary theory is an essential part of general economic theory through its relation to the theory of interest and, therefore, monetary policy is an important part of general economic policy.

G. D. H. Cole aptly observes "Modern Wars of any magnitude always leave behind them a legacy of monetary problems." It was so, after all the previous wars. It was so, to a great extent, after the World War of 1914 - 1918 and it was again so after Second World War. After every war, each country had to adjust its monetary conditions by taking important decisions about monetary policy according to the nature of difficulties, both internal and international, faced by each country. And monetary theory influences the monetary authorities in taking vital decisions in matters of monetary policy according to the changing economic needs.

After the First World War of 1914 -18, much importance was attached to the maintenance of domestic monetary stability which ran counter to the precepts of the gold standard, because monetary conditions in each country had been under the gold standard system, in pre-1914 governed by the international balance of payments position. The level of domestic costs and prices depended upon the expansion and extraction of the domestic money supply being determined by an inflow or outflow of gold.

All through the years following the First World War, individual countries grew more and more anxious to avoid the rigours of the World-wide cycle of booms and slumps. In the twenties economic policy was directed against the dangers of an excessive boom characterised mainly in terms of prices and credit inflation. In America and the United Kingdom many economic thinkers belonging to the monetary school laid emphasis on money and credit as the fundamental causes of the trade cycle. As such, importance was attached to monetary control as a means of minimising the fluctuations of the cycle.

The idea was that, if a price-inflated boom could be avoided through monetary controls, the succeeding depression could also be prevented. In the United States of America, for instance, experiment was made by the Federal Reserve System with various tools of monetary controls to stabilise prosperity in the twenties. When the boom did not manifest the price inflation, other monetary and financial factors, such as the rise of debt etc., were put forward as an explanation for the initiation of the deflationary process which, it was supposed, could be stopped by monetary measures alone. The failure to check the speculative movement in the U.S.A. stock exchange market resulting in its crash in the early thirties revealed the weakness of the monetary policy even as a device to check the boom.

Even with the onset of the Great Depression in the thirties the ardent advocates of the monetary school persisted in the view that all that was required to prevent depression and to restore full
economic activity was the expansion of money and credit by the central banks.

But the events of the Great Depression have proved the futility of the view held by the monetary theorists. In the United States and the United Kingdom, for raising economic activity from the abyss of depression, the cheap money policy was followed. The bank rate was lowered in the U.K. once in 1930 to 2 percent in order to encourage loans and advances to business. Similarly, in the U.S.A. during the depression, the cheap money policy was initiated by Hoover and intensified by Roosevelt as a part-policy of the New Deal. Interest rates were lowered; the credit base was expanded and every attempt was made to encourage the banks to give loans on a large scale to private industry. But all these attempts had only limited success both in the U.K. and the U.S.A. owing to the gloomy business outlook then prevailing.

In view of the importance attached to monetary controls as a means of minimising the fluctuations of trade cycle, the monetary theorist possibly missed the more deeply significant developments of the twenties in the field of investment. That the boom in the twenties was, at bottom, an investment boom and that the depression was inevitable once the investment outlets of the post-war period had reached a bottleneck, were not recognised by ardent followers of the monetary school. In the United States, for instance, there was a rise in investment activity in building and in half a dozen growing industries, such as the automobile and electrical industries.1

VII.

The ease of capital flotation in the twenties pushed up the investment more than it was economically justified. Very soon, investment reached the saturation point resulting in a deep depression in the thirties.

The Keynesian school of economists hold the view that the instability of investment was the main cause of the economic fluctuations in the inter-war period. In the capitalist countries, in the 1930's there existed a strong tendency for the actual level of investment to fall below what was needed for maintaining full employment. It was argued that, in the thirties, a surplus money over the necessaries of life was possessed by a large number of persons. This led to a growing "propensity to save" with a corresponding fall in the "propensity to consume." This increase was not fully or continuously balanced by the growth of the willingness of businessmen to undertake investment. According to Keynes, from the community standpoint, money "saved" but not "invested" in new capital assets is wasted. The determining factor in regulating the volume of investment, apart from the interest rate, is the expectation of profit. As the prospect of earning profit, in the 1930's by the businessmen was little, they were discouraged to invest in capital goods. As such, by mere injecting money and credit in sufficient quantity into the economic system by the monetary authorities resulting in the low interest rates, the depression could not be prevented.

1. Ibid. P. 75.
Economists were naturally concerned with the problems of reducing unemployment and stimulating a high level of production. The entire Keynesian approach arose out of a situation in which a large volume of material resources remained under-used.

The contention of Keynes and others was that monetary policy should have been adjusted as to fit in with the requirements of a right investment policy and the state had a responsibility in deciding and forming the right investment policy with a view to attaining and maintaining full employment.

The situation altogether changed with the out-break of World War II in 1939. The emergency created by the war required an increase in the supply of production by mobilising all material resources for war purposes. Governments of the belligerent countries were involved in expenditures. In order to meet these expenditures, the cheap money policy which had been in evidence in the leading countries like the U.K. and the U.S.A. ever since the days of the world depression of 1929-33, was vigorously pursued during the war. Its continuance, in the war-time, became a matter of necessity with belligerent countries to meet their huge war expenditure.

The volume of public debt during the war increased so enormously that, but for the low rates of interest, the burden of debt would have been unduly heavy. In order to ensure the success of the policy, a comprehensive and an elaborate technique of control of money capital and foreign exchange markets had to be developed.

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In order to increase war production attempts were made, by direct measures and physical controls, to reduce consumption and to keep the level of savings sufficiently high.
IX.

Capital investment was strictly regulated by means of Capital-Issues Control. The outflow of capital was stopped by a rigid control of the foreign exchange market. These controls together with high taxation of profit and other incomes checked inflation to a great extent and also helped the authorities in maintaining low interest rates. The rise in wholesale prices was moderate in the U. K. and the U. S. A. and other European countries with the exception of France, Greece and Hungary. All through the war period, in all belligerent countries, the treasury and the monetary authority acted jointly to pave the way for a continuous flow of money into the government's war chest with a view to financing the war.

Recent developments of monetary theory enable us to free ourselves from the bondage of classicism which relegated money to the background, and help us to appreciate that money mechanism has a distinct role to play in shaping the economic destiny of a nation. Apathy or ignorance in making a correct monetary diagnosis or unwillingness to apply the correct monetary policy must lead countries into difficulties as already done in many cases. The economic problems with which we are confronted today differ very much materially from the problems posed in the "General Theory" of Keynes. The General Theory is a "prescription" for fighting depression. In spite of the growth of the idea of state control of economic activity Keynes based his idea on the operation of "Free Economy" controlled by fiscal policy working in conjunction with a monetary policy to mitigate depression.

The Second World War brought in its wake a changed economic outlook. It would appear primitive today to talk of "Laissez Faire" or "unrestrained Capitalism" or of a "rigid" monetary policy conducted by central bank independently and without sanction from the government. Similarly, it is unimaginable today that modern governments will rely merely on the orthodox techniques of the central banking control to tide over the economic difficulties.

The "automaticism" of market economy was rendered useless by war and it became in the post-war years extremely unworkable. Manifold economic problems, such as budgetary deficits, redundant supply of money, inflation, capital deficiencies in both capital and consumption goods industries, adverse balance of payments position resulting in instability in exchange rates etc. cropped up in almost all countries, both belligerent and neutral. Statesmen, economists and ordinary men had all been faced with problems of economic dislocation of so vast a magnitude that it appeared almost inscrutable.

A monetary theory of the thirties does not fit in with the realities of the fifties. But that money has played a significant role in the past and is likely to play the same in the future cannot be ignored. A carefully laid out monetary policy in conjunction with fiscal policy is expected not only to heal the wound left behind by the Second World War, but also to help economic advancement of both developed and underdeveloped countries to a great extent.
The main purpose of this work is to attempt an examination of the economic problems and the monetary policies followed in the years following the Second World War in major countries of the world, such as, the United States, the United Kingdom, France, Western Germany, the Scandinavian countries and a few underdeveloped countries (including India) of Asia and the Far Eastern region. Further an attempt has been made to suggest measures in India more appropriate in the circumstances than those adopted elsewhere, so that our country may be in a position to develop her economy with great rapidity in order to keep pace with such countries which are economically much advanced.

An attempt has been made in the following pages, in the first place, to study the manifold economic problems such as, inflationary tendencies accompanied by the redundant money-supply and budgetary deficits, the disequilibrium in the balance of payments resulting in instability in exchange rates which confronted many belligerent and neutral countries after the Second World War as legacies of war-time conditions.

The next object has been to examine how major countries like the U. S. A., the U. K., France, Western Germany and the Scandinavian countries have tried to solve their respective problems by the introduction of monetary reforms, and a reorientation of monetary techniques, both quantitative and qualitative along with budgetary and other fiscal measures. The techniques of central banking control both quantitative and qualitative, and innovations in their use, with some degree of
selectiveness, being the most important feature of new monetary policy in the post-war period called for a little detailed study.

The political awakening of the under-developed countries together with their aspiration for economic progress led to adopt certain economic measures that offer an interesting study. Therefore, a chapter has been exclusively devoted to the analysis of post-war currency and monetary policies in a few under-developed countries of Asia and the Far-Eastern region, such as, China, the Philippines, Indochina, Indonesia, Thailand, Burma, Ceylon and Pakistan.

The weapons of monetary control were left unused or given only a minor role in the early post-war years as the cheap money policy which had become the rule in the depression of the thirties and the war time, was pursued till then. Concern about the cost of public debt, the desire to maintain low housing cost and a fear of the possible post-war recession added to the bias for cheap money. Moreover, it was felt that the programme of recovery after the destruction and dislocation caused by the war required easy money-conditions. There was a renewal of the monetary controls in the changed circumstances of the post-Korean war inflationary boom and it was also the result of a reassessment of the importance of monetary controls.

As in other underdeveloped countries, certain special lacunas, such as, restricted use of credit, absence of banking habits among the people particularly in rural areas, the disintegrated and disorganised structure of the money market and lack of a properly organised capital in India created difficulties in the way of a successful
monetary policy for a long time. The monetary policy which had been adopted in our country till the achievement of India's independence in August, 1947, was formulated only to suit the foreign economic interests, particularly that of the United Kingdom which ruled over India for two hundred years.

The war-time inflation in India which had been due to the inflationary methods of finance, forced upon the Government of India for meeting the war expenditure of the British and allied Governments, became more acute in the post-war years. As such, post-war inflation and other financial problems which confronted our country and the monetary and fiscal measures adopted by the Reserve Bank of India and the Government to counteract them, have been discussed at length.

The switching over from cheap money to dear money policy in India as elsewhere in the wake of the Korean war inflationary boom and the effects of the policy on Indian economy when the First Five Year Plan was in the process of implementation, have been studied in detail.

As time goes on, the inflationary pressure under the impact of deficit financing is assuming alarming proportions and it offers a challenge to any sound economic policy. Particularly at a time when India is launching into the implementation of the Second-Five-Year-Plan requiring huge financial resources, the necessity for a sound monetary and fiscal policy is being all the more keenly felt. The concluding chapter of this work has been devoted to the study of measures considered to be appropriate to meet the situation.

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The materials for this work have been collected from official and authoritative sources. The work is based on the information obtained from official reports, bulletins and papers published by the Department of Economic Affairs, the United Nations Organisation, the Organisation for European Economic Co-operation, International Monetary Fund, and sundry official publications of different governments and of banks and other recognised organisations.

With regard to India, information has been obtained from official publications of our government and the Reserve Bank of India.

Information relating to other countries has been gathered from foreign journals and bulletins, and Annual Reports of the Bank of International Settlements, the International Monetary Fund and Annual Reports of a few central banks.

The writer acknowledges his indebtedness to these sources.