II

THE UNIFICATION OF INDIAN CURRENCY IN THE
EARLY YEARS OF 19TH CENTURY

Towards the end of 18th century the Moghul Empire had fallen into ruin. The mechanism of its centralised control had become too feeble and the forces of disintegration in the country had become pronounced. The East India Company which had started its career in India as a trading concern had by this time gained considerable political foothold over this country. The company had gradually gained administrative power over the provinces of Bengal, Bombay and Madras. It was at this time in Indian history when a large number of independent rulers came into being and as a symbol of their sovereignty all of them had issued their own coins of various fineness and of different metals.

The currency confusion thus created caused considerable difficulty for the company in its trading. It was, therefore, to overcome this difficulty that the Company tried to bring about uniformity in the currency system of the territories governed by it. In its famous despatch of 1806 the Court of Directors of the Company asked the Governors of Bengal, Bombay and Madras to issue silver coins for use within the territories
under their administration. It was suggested that silver coins of 180 grains weight, containing 165 grains fine silver be issued.

An uniform silver currency system for the whole area under the Company's rule was adopted on account of the following reasons — (i) It could facilitate the expansion of trade of the Company; (ii) It could help in the maintenance of the intrinsic value of the currency. And the currency could be saved from continuous debasement; (iii) It could also help the territories under the E.I. Company to establish monometallism and thus eliminate the risk of operation of Gresham's Law that is always present under bimetallism. The suggestions were accepted by the Governments of Madras, Bengal and Bombay in 1818, 1819, and 1824 respectively. But, each one of these Governments instead of adopting silver monometallism, adopted silver and gold bimetallism. Both the coins of gold and silver were of 180 grains weight and 11/12 fineness.

In the year 1833, the British Parliament by an Act of its own established a central Government of India, which was to administer the three provinces. The power of the Central Government was vested in the Government of Bengal. The British Parliament by another Act in 1835 made the silver rupee of 180 grains (11/12 fine), the standard coin of British India. Though gold currency was officially demonetised it

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continued to be received in Government Treasuries. The exchange rate of gold to silver coins was 1:15.

There was, however, very soon a demand for the reintroduction of gold currency in India. The Indian economy was at this period gradually moving ahead from kind to cash economy. The East India Company which was annexing territories one after another had to make bigger payments to its soldiers and civilian employees. The supply of silver was therefore inadequate to meet its demand for currency. In the meanwhile Californian and Australian gold mines were discovered in 1848 and 1851 respectively, which consequently led to a steep fall in price of gold. The market value of gold sovereigns and half sovereigns came down to £1.10 and £5. This resulted in a loss to the Government who were so long receiving gold coins at the official rate. Accepting gold in Government treasuries was therefore stopped from the 1st January, 1853. In the meantime the British Government had directly taken over the administration of India and a Central Government for India under a Viceroy was established. Under these circumstances a currency commission was appointed in 1866.

THE MANSFIELD COMMISSION

The currency commission of 1866 was named after its Chairman Sir William Mansfield. The Mansfield Commission after studying the then existing currency problems of India
made the following recommendations:

1) Gold coins of the value of 15, 10 and 5 be made the legal tender money for British India.

2) The Indian currency system should consist of gold, silver and paper currencies.

3) Currency notes of universal acceptability may be issued.

None of the recommendations of the commission was accepted by the Government. In 1868 the Government raised the value of gold sovereigns from 10 to 10 - 8 annas and that of half sovereigns from 5 to 5 - 4 annas. This was done in order to attract gold to the treasuries. At this rate sovereigns and half sovereigns were to be received in Government treasuries. Shortly after this the value of silver in terms of gold began to fall and from 60½ d. per ounce in 1871 - 72, the price of silver fell to 58 d. per ounce in 1875 - 76 and to 39 d. in 1892 - 93. In between the years 1873 and 1893 the fall in the value of silver in terms of gold was 40%.

THE RUPEE - POUND EXCHANGE RATE

The Rupee - Pound exchange was always stable before 1873. It was stable at Rs.1=15, 10½ d. from the year 1873 onwards the rate of exchange of the rupee to pound started
falling and it reached the lowest point at 1 s. 3 d. to the rupee in 1892 - 93. This fall in the exchange value of the Rupee was on account of an increase in the output of silver, which made the metal cheap. Many of the European countries which gave up silver standard and adopted gold monometallism started selling off their surplus silver. Thus an excessive supply of the metal from the European countries and a fall in the world price of it caused the value of silver Rupee fall in terms of pound which was of gold. A falling exchange rate of the Rupee caused the following difficulties — (i) It meant a higher amount of rupee payment for home charges; (ii) the requirement of a larger amount of Rupees for the payment of interest and repayment of debts contracted in pound; (iii) a loss in income to European officers employed in India, who made remittances abroad; (iv) an increase in the cost of goods imported from U.K.; and (v) an uncertainty in trade.

THE HIRSCHHULL COMMITTEE, 1892

The Government of India therefore appointed a committee known as "Hirschhull Committee" in 1892. The Committee had to consider whether the free coinage of silver Rupee was to be stopped in order to raise the value of silver coins and also whether gold standard should be introduced.

The Committee made the following recommendations:

1) Neither gold nor silver be allowed to be freely minted.
2) The silver rupee should be unlimited legal tender.

3) Gold should be received in Government treasuries at 1 S. 6 d. per Rupee.

The Currency Act of 1893 accepted the recommendations of the Committee. Mints were closed for the free coinage of silver. Sovereigns and half sovereigns were to be received for payment of public dues at 16 d. per Rupee.

Within a few years, after the mints were closed for the free coinage of silver rupees, there was no shortage of silver rupees in the market. The exchange rate of the Rupee showed the signs of having gained strength. But thereafter, an acute shortage of currency supply was gradually felt. The Currency Act of 1893, rationalised the money market by closing down the mints. It was effective only in contracting the currency but unfortunately had made no arrangement for expansion. The full flexibility of currency system was absent.

THE FOWLER COMMITTEE, 1898

In 1898 the Fowler Committee was appointed to advise the Government of India about the establishment of a sound currency system and a stable exchange rate. The Committee received two schemes from two gentlemen who were not members of the Committee. One of the two came from Mr. Lindsay and the other from Sir Besley Probyn. Both these schemes for
the working of the Indian currency system were rejected by the Committee. Though these schemes of Lindsay and Groblyn were rejected by the Fowler Committee, in the latter years the Indian currency system worked on these very schemes.

The Fowler Committee made the following recommendations:

1) Indian Mints should freely coin sovereigns and half sovereigns;

2) The silver rupee was to stay as an unlimited legal tender money;

3) The mints for the coinage of silver rupee should remain open, so long as the supply of gold coins did not exceed their demand;

4) The Rupee: Pound exchange rate should be fixed at Re.1 = 1 S. 4 d.;

5) The Government should change gold for Rupees but it should not be binding on it to give gold in exchange of silver;

6) The profit made out of the coinage of silver rupees be accumulated in a Reserve Fund.

The Government of India incorporated the recommendations of the Fowler Committee in its Currency Act of 1899. The gold sovereigns and half sovereigns were made legal tender money in India. The exchange value of the Rupees was fixed at 1.15 for £ 1. Out of the profit made from silver coinage a fund called "Gold Reserve" was created. An attempt was also made to open a mint for the coinage of gold in India.
but it was ultimately given up in 1902.

THE GOLD EXCHANGE STANDARD

Gold coins were issued in India under the Act of 1899. The circumstances were adverse to the monetary circulation of gold coins in India. It was a year of famine in the country and as such the people did not at all require coins of higher denomination. Gold coins soon started flowing back to the Government Treasuries and there was an increased demand for silver rupees and other coins of smaller value. This situation and the later developments, which followed as a consequence of it have been summarised by Dr. K.N. Raj in the following words, "The failure of the attempts to implement the recommendations of the Fowler Committee and the unexpected evolution into a Gold Exchange Standard is quite well known. When gold currency failed to become popular and such gold coins as were injected into the system were faithfully returned to the mint, the only alternative open was to keep the rupee as legal tender and to take steps to ensure its convertibility into international currency at an approximately stable rate". ¹

By his Notifications of 1904 and 1907 the Secretary of States for India, brought the working of the Indian currency and exchange system close to the proposals of Mr. Lindsay and Sir Lesley Probyn. The notification of 1904 announced the willingness of the Secretary of States to exchange rupees for sterling without limit at the rate of 1 s. 4 d. to the

¹ Dr. K.N. Raj: The Monetary Policy of the Reserve Bank of India, p. 51.
Rupee. The profit made out of the coinage of silver rupees was to be retained in the reserve fund called — Gold Reserve, which was to be located in London and invested in sterling securities. The Notification of 1907 required the opening of a Rupee Branch of the Gold Reserve Fund in India. This branch was required to supply on demand Rupees for Sterling at the rate of 1 S. 4 d. to the Rupee. It was thought that this would help the currency authorities in India to check any rise in the exchange value of the Rupee.

The nomenclature of the fund called Gold Reserve was changed to Gold Standard Reserve. It was now made of two parts. One of the two parts was located in London and its income was invested in Sterling securities. The other part which was called Rupee Branch was located in India. Thus gradually we drifted to the Gold Exchange Standard and remained faithfully tied to it until Britain went off the Gold Standard in 1931. After Britain had given up Gold Standard in September, 1931, we found our currency and exchange system having automatically shifted over to the Sterling Exchange Standard.

Though the Gold Exchange Standard was severely criticised, it had many advantages. The system worked economically. The Indian currency could enjoy the prestige of a Gold Standard currency system without using gold for currency purposes. The Indian currency was linked to an
The gold exchange standard worked in India through the Council and Reverse Council Bills. The Council Bills were sold to the British importers of Indian goods by the Secretary of States. The British importers of Indian goods, the banks in Britain and all other persons and concerns in Britain who were in need of Rupees for payment in India, could get the same on depositing an equivalent amount in Pound with the Secretary of States. The Secretary of States would thereafter issue the Council Bills in favour of the depositor. The Council Bills were in the nature of orders from the Secretary of States to the Government of India, for the payment of the amount indicated therein in rupees. The Council drafts could be sent either by post or by telegraph. In the former case it was called Council Bills and in the latter case
Telegraphic Transfers. The rate at which the Council Drafts were to be sold was determined from time to time by the Secretary of State.

Similarly, the Government of India sold Reverse Council draft in India. It was like an intimation from the Government of India to the Secretary of State to pay Pound in U.K. to such individuals and concerns, who had deposited Rupees in India. The rate at which the Reverse Council Bills were sold was to be not lower than 1 S. 29 32 d. to the Rupee. The sale of Reverse Council Bill was very rare, as it was demanded only on such occasions when India's imports exceeded her exports. The country had generally an export surplus, which enabled her to meet the Home Charges. The sale of Council and Reverse Council Drafts stabilised the exchange value of the Rupee at about 1 S. 4 d. It could fluctuate only between 1 S. 29 32 d. and 1 S. 4 1/2 d.

The proceeds of the Council Bills were credited in parts to the Secretary of State's balances held with the Bank of England, the Paper currency Reserve held in gold in England and to the Gold Standard Reserve. The payments of the Council Bills were made out of the Rupee part of the Gold Standard Reserve held in India and the Rupee part of the Paper currency Reserve held in India.

The proceeds of the sale of Reverse Council Bills were either credited to the balances of the Government of
India or to the Paper Currency Reserve. The payments of Reverse Council Bills were made either out of the balances of the Secretary of States held in London or from the Gold Standard Reserve held there.

THE CHAMBERLAIN COMMISSION, 1913

In the year 1913 the Chamberlain Commission was appointed to make suggestions regarding the following:

1) The measures to be adopted for the maintenance of the stability of the exchange rate of the Rupee.

2) The appropriate place for the location of Government of India's balances and the principles to be followed for its general management.

3) How should the Paper currency and Gold Standard Reserves be utilised?

The Commission favoured the continuation of gold exchange standard, as it was not only prevalent in India but in many other countries of Europe. In order to maintain the gold exchange standard, the Commission felt that an unlimited amount of Reserves of gold and sterling securities be held in London. The Rupee Branch of the Gold Standard Reserve was to be abolished. The Commission recommended a more elastic system of note-issue and of a bigger amount of its issue against securities. It also recommended the issue of notes of the denomination of Rs. 500/- and also suggested that the financial year should commence

from 1st January or 1st November instead of commencing from 1st April. The Commission recommended that a Central Bank be established in India.

A few months after the Commission's report was published, the First World War broke out. (The Report was published in February, 1914 and the war broke out in July, 1914). Therefore, the only recommendation of the Commission that was accepted was the abolition of the Rupee branch of the Gold Standard Reserve.

THE FIRST WORLD WAR

Thus, just before the World War I, the Indian currency was partly composed of silver coins and partly of Paper Notes. Gold coins were freely accepted in payments, but they were not minted freely in Government mints. The country had a gold exchange standard, the Rupee being tied to the Pound. The rate of exchange of the Rupee was maintained close to 1 S. 4 d. On the 31st March, 1914 out of the total issued paper currency of Rs. 66 crores notes worth, Rs. 52 crores were in active circulation. The fiduciary portion of the total notes issued was worth Rs. 14 crores. Notes for Rs. 10 crores were issued against Rupee securities and Rs. 4 crores worth against Sterling securities.1 The total value of the gold

and silver currencies in circulation in India at this time was much more than that of the notes in circulation. ¹

Paper currency was not so popular in India for the following reasons:

1) The people had never used paper currency in the past and after it was issued for the first time in 1809, it could not be acceptable to the people except for the small section of educated persons.

2) Notes of only high denomination were issued in the beginning. The issue of five rupee notes was made as late as in 1891.

3) The currency circle system had prevented the wider circulation of notes. The country was divided into four or more circles and notes issued in one circle could not circulate in another circle.

At the outbreak of the war, India's foreign trade received a setback. The export and import trade both steeply declined. In the initial stages of the war, the Indian currency and exchange system also faced a crisis of confidence. There was a large withdrawal of deposits from the post office savings bank. The Government made all necessary arrangements

¹ For an exact estimate of the circulation of total amount of silver and gold currency on 30th April, 1914, see Reserve Bank of India: Banking and Monetary Statistics of India. Currency and Coinage, p. 673.
for withdrawal by those who wanted to do so. Thus within
two months of the war, out of a total Post Office Savings Bank
deposit of Rs. 24½ crores, Rs. 6 crores were withdrawn. Large
amounts of currency notes were continuously presented at the
Government treasuries for conversion into gold. The Govern-
ment faced this situation firmly and issued gold for notes.
Upto the 5th August, 1914, notes worth Rs. 10 crores were con-
verted into gold. Thereafter gold coins were issued only to
those who needed them for genuine trade purposes. On account
of an adverse balance of trade in the beginning of the war,
there was a great demand for Sterling for payment in U.K.
This weakened the exchange position of the Rupee. The Govern-
ment took prompt action to meet the situation and started
selling Sterling drafts payable in U.K.

All these actions taken promptly by the Government
restored confidence in the minds of the people. The unusual
withdrawal of deposits from post offices stopped as also the
abnormal demand for conversion of currency notes.

There again cropped up some problems in the working
of the Indian Currency and exchange from the end of 1916.
There was an unusually large amount of export surplus on
account of the following reasons — (1) an increase in demand
of Indian goods at higher prices by the Allied Powers; (ii)
a fall in the import of goods from U.K. and the Allied
countries. Imports from Germany and Austria had totally
stopped. There was therefore a very heavy demand for Council Drafts in U.K. The Government of India faced a very critical situation. It was very difficult for her to make payments of all the Council Drafts presented, as her capacity to pay for them was limited by the amount of currency she could issue and this too was limited by her capacity to acquire silver for minting coins. Large scale import of silver was also not possible on account of a fall in its world supply. The price of silver went up from 27½ d. per ounce in 1915 to 43 d. per ounce in August, 1917. With an increase in the value of silver, the exchange rate of the rupee also moved up. The official rate of exchange at 1 s. 4 d. to the Rupee soon broke down and with every increase in the price of silver, the exchange rate of the Rupee was revised upward. On the 12th April, 1918, the exchange rate of the Rupee moved up to 1 s. 6 d., and on the 12th December, 1919, it was 2 s. 4 d.

The shortage of silver for coinage was met by the enactment by the United States of Pittman Act of 1918. This enabled India to obtain 200 million ounces of pure silver from the U.S.A. The Act IX of 1917 raised the fiduciary issue limit of the currency from 26 crores to 62 crores. "If this huge quantity of silver had not been received there might have been a serious currency crisis in India and the convertibility of currency notes into silver rupees would
have had to be suspended. 1

THE POST-WAR PERIOD

In 1919 the Babington Smith Committee was appointed. It was entrusted with the task of examining the effects of war on the Indian Currency and Exchange and to suggest if any change in the Indian Currency and Exchange system was needed. It had also to advise about the measures to stabilise the rate of exchange. 2

The Committee recommended that the rupee exchange rate be fixed at 2 5. (gold) i.e., £10/6 per sovereign. Thus the exchange rate of the Rupee was fixed sufficiently high and that too in terms of gold and not Sterling. It was presumed that the higher exchange rate of Indian Rupee would keep down the internal prices. The imported goods would be cheaper and also there would be a fall in the export of goods. All these consequences following a higher exchange rate of the Rupee were to help in checking rising prices in India.

The value of Sterling had considerably depreciated at the end of the First World War. It had gone so low that one pound Sterling (Paper) was equivalent to 0.78 of Pound Sovereign (gold). The Committee, therefore, thought that

as the Indian currency was silver based, it was more appropriate to link it with pound gold and not with Paper Sterling and thus avoid excessive fluctuations in the exchange value of the Rupee. The other recommendations of the Committee made, were as follows:

1) Council drafts should be sold by the Secretary of States only for genuine trade requirements.

2) When the exchange rate of the Rupee gets weak, Reverse Council drafts be sold in India, without any previous reference being made to the Secretary of States.

3) There should be a free export and import of gold and silver from and into India.

4) The Banking and investment facilities in India be improved.

5) The statutory minimum value of the metallic portion of the Paper currency Reserve was to be 40 per cent of the gross circulation of notes.

6) The Exchange rate of the Sovereign to the Rupee should be £ 1 (Sovereign) = Rs.15.

7) Profit on the coinage of the Rupee should be credited to the Gold Standard Reserve.

8) The silver and gold portions of the Paper Currency Reserve be held in India.

The Government accepted the recommendations of the Committee and fixed the exchange rate of the Rupee at
recommended high level of 2 s. gold. But very soon the exchange rate of the Rupee started coming down. All the attempts the Government made to keep it at 2 s. gold proved of no avail. At the end of the First World War, we had an adverse balance of trade and as such the demand for Sterling drafts was very high. This situation of an unusual increase in the demand for Sterling was further accentuated on account of the anxiety of the European business men in India to transfer their accumulated profit to England. The price of silver had also started falling. It went down from 99½ d. per ounce in February, 1920 to 44 d. per ounce in June, in the same year. The general price level in Britain started falling along with the fall in many other countries of the world.

THE EXCHANGE RATE CRISIS

The Government tried at first to maintain the exchange rate of the Rupee at 2 s. (gold) but failed. Then from 24th June to 28th September, it tried to maintain it at 2 s. Sterling but the market value of the Rupee in the meantime having fallen further, this attempt too was abortive. The Government of India could maintain the high exchange rate of the Rupee only by means of large scale currency contraction. But this would have upset the internal economy. The Royal Commission on Indian Currency and Finance, 1926, analysed the situation in the following words. "The Government of India at the moment was unable to contract Currency in India at the rate at which world prices were falling. All they
could do was to avoid further inflation and to effect some measure of contraction".  

The payments for the Reverse Councils sold first at 2 S. gold and later on at 2 S. Sterling were made out of the sales of Sterling Securities and Treasury Bills in the Paper Currency Reserve. The rates at which Sterling Drafts were sold, were much lower than the rates at which they were purchased. The loss suffered by the Government on this account was in 40 crores.

Ultimately the Government gave up its vain attempt to maintain the exchange value of the Rupee at even 2 S. Sterling. In September, 1920, it stopped the sale of Reverse Council Bills. The exchange rate of the Rupee continued to move downwards. The only action the Government took at the time was to contract currency at a moderate rate so as to adjust Indian price to the falling price level of the world. But the downward movement of the world price was much steeper.

In March, 1921, the exchange value of the Rupee fell as low as 1 S. 2½ d. (Sterling) i.e., less than 1 S. gold. In 1922, the balance of trade was in our favour and in January, 1923, the exchange rate of the Rupee rose to 1 S. 4 d.—the pre-war level. From January, 1923 to June, 1924, the

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exchange rate of the Rupee fluctuated between 1 S. 4\(\frac{1}{32}\) d. to
1 S. 5\(\frac{7}{32}\) d. Sterling but it was stable at 1 S. 5 d. gold.
The exchange rate rose to 1 S. 6 d. gold in October, 1924.
From the end of May, 1925, the exchange rate of the Rupee
was almost stable at 1 S. 6 d. gold.

The Government became conscious of this new situa-
tion and tried to stabilise the exchange rate of the Rupee
at 1 S. 6 d. Sterling, rather than let it move further up.
It purchased Sterling at 1 S. 6 d. to the Rupee for payments
in India.

ROYAL COMMISSION ON INDIAN CURRENCY AND EXCHANGE, 1925

In 1925, Gold Standard was restored in the United
Kingdom. In August, of the same year, a Royal Commission
called Hilton Young Commission was appointed, to enquire into
the working of the Indian Currency and Exchange system. About
its terms of reference, the Commission wrote, "we the under-
signed commissioners are appointed to examine and report on
the Indian Exchange and Currency system and practice; to
consider whether any modifications are desirable in the
interest of India and to make recommendations".¹ The Comm-
ission made the following recommendations:

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¹. Opening Paragraph : Report of the Royal Commission on
    Indian Currency and Finance, 1926.
1) That Gold Bullion Standard should be introduced in India. The selling price of 400 oz. gold bars for delivery at Bombay or London be fixed at £21. 3 as. 10 p. per tola.

2) That there should be a Central Bank for India which only should issue currency notes.

3) The system of paying in silver for notes presented in Government treasuries was to be discontinued.

4) Gold currency was to be withdrawn from circulation.

5) The exchange rate of the Rupee was to be stabilised at 1 s. 6 d.

6) The Commission was not in favour of the maintenance of two separate reserves — the Paper Currency Reserve and Gold Standard Reserve. It favoured their amalgamation.

Sir Purabotandas Thakurdas - a member of the Commission - disagreed with the majority recommendations and favoured the exchange rate of the Rupee to be fixed at 1 s. 4 d.

In March, 1927, a Currency Law was passed incorporating the recommendations of the Commission. Under this Law, (i) the exchange rate of the Rupee was fixed at 1 s. 6 d.; (ii) the Government announced its willingness to purchase and sell 400 oz. gold bars to be delivered in London at the rate of £21. 3 as. 10 p. per tola; (iii) Gold Sovereigns and half Sovereigns ceased to be legal tender in India. The Reserve Bank of India Bill which was introduced in the Central Legislative Council in January, 1927 was ultimately
dropped. Thus no Central Bank could be established.

The Hilton Young Commission was the last of the Currency and Exchange Commissions for India appointed by the British Government.

THE 1 S. 6 d. RATIO AND THE FOREIGN EXCHANGE CRISIS

The Currency Act of 1927 became operative from 1st April, 1927. From this date to the end of September, 1927, there was a remarkable improvement in India's foreign trade. Both exports and imports increased. This improvement in our foreign trade position reflected the improvement in world trade conditions and was not because of any stability of the Rupee exchange rate at 1 s. 6 d., which was rather showing the signs of weakness between April, 1927 and October, 1927. Between these two dates even the highest quotation for the Rupee was below 1 s. 6 d. From November, 1927 to February, 1928, there was some firmness in the exchange rate of the Rupee. The highest rate for L.I. for payment in London was at 1 s. 6 3/32 d. to the Rupee in between November and December, 1927. The Rupee exchange rate again showed symptoms of weakness continually thereafter with a break in between October, 1928 to January, 1929. The highest quotation in between October and November, 1928 for L.I. to be paid at London was at 1 s. 6 1/16 d. to the Rupee. From February, 1929, the exchange rate of the Rupee began to fall and it was never quoted at 1 s. 6 d. the lowest and the
highest quotations for T.T. for delivery in London in March, 1930 were 1 S. \( \frac{13}{16} \) d. and 1 S. \( \frac{27}{32} \) d. \(^1\) respectively. In order to maintain the exchange rate of the Rupee at 1 S. 6 d., the Government resorted to a deflationary practice. Currency contraction was made by means of open market operations. Treasury Bills were sold in the market and thus currency supply was reduced.

The post-war boom which had continued for several years ended at last and in September, 1929, the world economy turned to the reverse direction. The depression started in U.S.A. and U.K. almost simultaneously. It was also visible in many other countries of the world. The Indian economy was no exception to the situation. "The causes of the world depression since 1929, originated mainly outside India and its course shows how intimately economic conditions in India have come to depend on industrial and trade activity in other countries of the world."\(^2\) Price of both agricultural and manufactured goods started falling but the former fell faster than the latter. India being primarily an agricultural country, the value of its exports declined sharply. The exchange rate of the Rupee further weakened. The Government sold Treasury Bills in large amounts and thus contracted

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currency. This policy of the Government accentuated the already falling prices in India. There was much discontent in the country against such a policy of the Government.

**THE FALLING PRICES AND EXCHANGE, 1931 - 37**

On the 21st September, 1931, Britain went off the Gold Standard. It suspended sub-section (ii) of Section I of Gold Standard Act of 1925, which made it obligatory for the Bank of England to convert pound notes into gold on demand. Most of the South American countries, Australia and New Zealand had suspended Gold Standard earlier. Great Britain’s example was followed by the Scandinavian countries, Greece and Portugal in Europe and outside Europe by Japan and South Africa. "In April, 1933, even the Almighty Dollar suspended gold convertibility and depreciated". The failure of gold standard in Britain and in these countries was due to the following reasons:

1) All the countries which had been on gold standard, though desirous of maintaining a stable exchange rate of their respective currencies, were not ready to move with the rest of world’s economic condition, which is so essential for Gold Standard. Each country attached more importance to its own economy than to co-operation with the rest of the world for the survival of gold standard. "The gold standard will work only if every nation is content to march in step with

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every other. But this was what the Central Banks after the war were not prepared to do.\textsuperscript{1} In Britain, some leading economists advocated internal price stability rather than exchange stability. As price stability was incompatible with the exchange rate stability of the pound, the Gold Standard was given up.

2) The task of maintaining exchange rate stability under gold standard at the end of World War I, was more difficult than before. Maintaining a stable exchange rate under the Gold Standard meant that all the countries on it should permit the free flow of gold inside and outside their countries and should simultaneously adjust their internal prices according to gold movements, so as to check such movements in gold. No country was prepared to adjust its internal prices to the whims of gold movements.

3) No country followed the Golden Rule of the Gold Standard. Rather when gold was coming in, they allowed it to be piled up in their reserves and did not expand currency and credit so as to raise prices and stop an inflow of gold within the country. On the other hand when gold was flowing out they allowed it to go, and instead of contracting and credit, they simply reduced the limit of gold to be held in their currency reserves.

\textsuperscript{1} G. G. Growther: An Outline of Money, Gold Standard, p. 355.
4) The world was divided into two groups - one gaining gold and the other losing it. The countries in the former group had a continuous hunger for gold and those in the latter group had a chronic tendency to lose it. For sometime gold standard could work in the losing countries as they borrowed from those who gained it. Great Britain, though she was losing gold could manage her affairs with the funds borrowed at a high rate of interest.

But soon these borrowing countries had to face a crisis. A fear that the borrowing countries may not be able to repay, caused the lenders of these short-term funds to call back their loans. The borrowers could not immediately repay them in full. In 1931, Austria and Germany had to restrict the repayment of debts to foreigners. "Great Britain's creditors withdrew their loans in gold until in September, 1931, the approaching exhaustion of the gold reserve of the Bank of England forced the Government to suspend gold standard. The crisis of 1931, was sudden but the seeds of it had been sown for several years before".1

The suspension of Gold Standard in Britain caused the depreciation of the Sterling in terms of gold. Those countries which had their currency reserve in British currency and securities found their reserves reduced in terms of gold.

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"And they were in most cases impelled to devalue their own currencies by at least as much as the British Currency fell in value". ¹

The day, Britain went off the Gold Standard, in India the Governor General in Council by Ordinance VI of 1931, suspended the operation of Gold Standard. It was thereafter not binding on the Government of India to sell gold or sterling in India for Rupees. The Ordinance VI was followed by Ordinance VII of 24th September, 1931, which made it binding for the Government of India to sell sterling or gold at 1 S. 6 d. Sterling for the Rupee for genuine trade purposes and for personal use, for an amount of not less than Rs. 25,000. It also authorised the Managing Governor of the Imperial Bank to call upon any bank to satisfy him that the purchase of sterling and gold was made for genuine trade purposes.

There were many people who opposed the linking of the Rupee to 1 S. 6 d. Sterling and advocated its link to 1 S. 6 d. gold. Another group of people wanted that the Rupee should be left free to find out its own rate of exchange. Both these measures would have been inappropriate at this time. The first would have overvalued the Rupee and consequently our export trade would have suffered. It would have suffered

more than usual as the symptoms of depression had already become visible in the year 1929. The second measure would have caused much uncertainty in the sphere of our foreign trade. The profits and losses of the export and import trades would have entirely depended on the fluctuations of exchange rates only. As our foreign trade was mostly with U.K. and our payments obligations were mostly in British pound sterling, it was quite appropriate that the exchange rate of the rupee was fixed at 1 S. 6 d. sterling. In the words of Secretary of States for India, "For all practical purposes the stability of the Indian exchange has been based on sterling. The greater part of India's external obligations is in terms of sterling. To follow gold and to increase the sterling value of rupee at this juncture is, I am sure you will agree, out of question. It has therefore been decided to maintain the present currency standard on a sterling basis. I am satisfied that this is the right course for India and is most conducive to Indian interests".  

The linking of Rupee to 1 S. 6 d. Sterling meant a depreciation of the exchange value of the Rupee. This depreciation had a favourable effect on our export trade. But as the world price level was rapidly moving downwards, particularly the prices of agricultural commodities, the depreciation of

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1. Quoted by Dr. L.C. Jain: The Monetary Problem of India, p. 42. Proceedings of Federal Structure Committee, p. 77. Indian Round Table Conference (Second Session), 1932.
the Rupee was not very effective in stimulating our export trade.

The three other most controversial issues of the period besides the fixing of the value of Rupee at 1 s. 6 d. Sterling were — (i) the export of gold from India; (ii) the controversy whether the Rupee should be fixed at 1 s. 6 d. or 1 s. 4 d. and the (iii) distress of the Indian cultivators on account of a fall in the prices of agricultural products.

THE OUTFLOW OF GOLD

From the year 1931 - 32 to 1939 - 40, there was a continuous outflow of gold from India. The following figures would give an idea about its magnitude:

<table>
<thead>
<tr>
<th>Year</th>
<th>Net amount of gold exported (millions of fine oz.)</th>
<th>Value in crores of Rupees</th>
<th>Average price of gold per tala (in Rupees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1931-32</td>
<td>7.62</td>
<td>57.97</td>
<td>25 - 9 - 0</td>
</tr>
<tr>
<td>1932-33</td>
<td>8.35</td>
<td>65.52</td>
<td>30 - 9 - 0</td>
</tr>
<tr>
<td>1933-34</td>
<td>6.69</td>
<td>57.05</td>
<td>33 - 4 - 0</td>
</tr>
<tr>
<td>1934-35</td>
<td>5.69</td>
<td>52.53</td>
<td>35 - 7 - 0</td>
</tr>
<tr>
<td>1935-36</td>
<td>4.01</td>
<td>37.35</td>
<td>35 - 8 - 0</td>
</tr>
<tr>
<td>1936-37</td>
<td>3.01</td>
<td>27.84</td>
<td>35 - 10 - 0</td>
</tr>
<tr>
<td>1937-38</td>
<td>1.76</td>
<td>16.33</td>
<td>36 - 1 - 0</td>
</tr>
<tr>
<td>1938-39</td>
<td>2.58*</td>
<td>23.26*</td>
<td>37 - 12 - 0</td>
</tr>
<tr>
<td>1939-40</td>
<td>4.15+</td>
<td>44.64*</td>
<td>41 - 14 - 0</td>
</tr>
</tbody>
</table>

* Including 1,039,420 ounces of gold valued at 1,10,19 lakhs earmarked on account of purchasers abroad.
† Including 789,947 ounces of gold valued at 8,08,08,376 lakhs earmarked on account of purchasers abroad.

The main reason for the outflow of gold from India was the fall in the prices of agricultural products which made the farmers poor. The gold exported has been called "distressed gold", because due to fall in their incomes, the farmers were unable to buy necessities, pay revenues and discharge their debts and had to sell off whatever gold they had to meet these charges.

Gold unloaded by the farmers was exported because there was a difference between the Sterling and Rupee price of gold. The Sterling price was higher than the Rupee price, and as such bullion dealers found it profitable to export it. Had the exchange rate of the Rupee appreciated, it would have liquidated the profit made out of the sale of gold by the bullion dealers.

Opinions were divided on the issue of gold exports. The official view was in favour of gold exports from India. It was argued that the export of gold helped us to maintain the exchange rate of the Rupee at 1 b. 6 d.

The value of exports and imports shrank heavily after 1931, and therefore India's favourable balance of trade in merchandise also fell. The actual position in regard to total balance of trade was, however, changed by the heavy exports of gold which compensated the fall in exports of our merchandise. The following table would explain the export and import trade position of India from 1931 to 1940.
<table>
<thead>
<tr>
<th>Year</th>
<th>Value of exports in merchandise including re-exports</th>
<th>Value of imports of merchandise</th>
<th>Total visible balance of trade in merchandise</th>
<th>Net Export or Import of Trade</th>
<th>Total visible Balance of Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>1931-32</td>
<td>160.55</td>
<td>125.72</td>
<td>+34.83</td>
<td>+55.65</td>
<td>+90.48</td>
</tr>
<tr>
<td>1932-33</td>
<td>135.49</td>
<td>132.27</td>
<td>+ 3.22</td>
<td>+64.93</td>
<td>+68.15</td>
</tr>
<tr>
<td>1933-34</td>
<td>149.73</td>
<td>114.99</td>
<td>+34.74</td>
<td>+57.23</td>
<td>+91.97</td>
</tr>
<tr>
<td>1934-35</td>
<td>155.22</td>
<td>131.80</td>
<td>+23.42</td>
<td>+52.54</td>
<td>+75.96</td>
</tr>
<tr>
<td>1935-36</td>
<td>164.29</td>
<td>133.69</td>
<td>+30.60</td>
<td>+36.37</td>
<td>+66.97</td>
</tr>
<tr>
<td>1936-37</td>
<td>202.33</td>
<td>124.58</td>
<td>+77.75</td>
<td>+14.50</td>
<td>+92.5</td>
</tr>
<tr>
<td>1937-38</td>
<td>202.63</td>
<td>159.18</td>
<td>+43.45</td>
<td>+15.11</td>
<td>+58.66</td>
</tr>
<tr>
<td>1938-39</td>
<td>180.29</td>
<td>137.22</td>
<td>+43.07</td>
<td>+22.79</td>
<td>+65.82</td>
</tr>
<tr>
<td>1939-40</td>
<td>80.99</td>
<td>60.86</td>
<td>+20.13</td>
<td>5.84</td>
<td>+25.61</td>
</tr>
</tbody>
</table>

(April - August)

It may be seen that the total visible trade for the whole period was in favour of India and that the amount of surplus was fairly large. But the balance of trade in merchandise

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fell as low as 33 crores in 1932-33, increased thereafter to 77 crores in 1936-37 and fell again to 43 crores in 1937-38. For India, excluding Burma, the balance of trade in merchandise and the total visible balance of trade were as follows:

**TABLE - 7**

**BALANCE OF TRADE - (1935-36 TO 1939-40)*

(Crores of rupees)

<table>
<thead>
<tr>
<th>Year</th>
<th>Balance of trade in merchandise</th>
<th>Total visible balance of trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>1935-36</td>
<td>+5.1</td>
<td>+40.5</td>
</tr>
<tr>
<td>1936-37</td>
<td>+51.2</td>
<td>+64.9</td>
</tr>
<tr>
<td>1937-38</td>
<td>+15.9</td>
<td>+30.2</td>
</tr>
<tr>
<td>1938-39</td>
<td>+17.4</td>
<td>+29.3</td>
</tr>
<tr>
<td>1939-40</td>
<td>+7.0</td>
<td>+12.2</td>
</tr>
</tbody>
</table>

(April to August)


The export of gold helped India to pay her foreign obligations including debt obligations which were maturing during these years. It also helped to maintain the exchange rate of the Rupee at 1 S. 6 d. Debt amounting to £ 15, million Sterling which matured in 1932 was paid off. The sale of gold helped the people to tide over their economic distress and it would have been most improper for the Government
of India to have adopted any method to check the people from selling their gold — a metal which is generally hoarded to tide over such difficult times. The sale of gold helped people to gain a profit as its value was continuously rising. It was also argued, that the Western countries, which were hoarding gold were justified in their action, because they had many international commitments and as such, to strengthen their currencies they should have accumulated gold. But India on the contrary had no such commitments and therefore, there was no harm if she lost gold. Secondly, many of the Western countries were preparing for the restoration of the gold standard. Dr. B.P. Adarkar wrote, "The Western countries do not want to be caught napping if there is a general return of gold". ¹ Thirdly, it was said that U.K. and U.S.A. needed gold for their Exchange Equalisation Accounts. Fourthly, the people in some of the Western countries had lost faith in their currencies and therefore were justified in accumulating and hoarding gold. Finally, it was argued that, "The masses have now got sufficiently accustomed to some form of token currency whether it be rupee or notes. It would therefore, be unnecessary to invest the nations resources in non-interest bearing assets like gold". ² The supporters of gold exports argued that the liquidation of


2. Ibid., p. 315.
gold hoards also meant a greater use of currency notes, savings certificates, etc., by the people. The most important person amongst the supporters of gold exports was Sir George Schuster, the Finance Member of the Governor Generals' Council. Some Indian economists like Prof. Adarkar also favoured gold export from India.

The Currency League of India, which was formed at this time to enlighten the people about the currency and exchange problems of the country was the most vocal opponent of gold export. The export of gold was also opposed by many eminent economists, outside the Currency League of India. The main arguments against gold export was that export of gold from India meant the liquidation of the past savings of the Indian people, as savings in India are mostly hoarded in gold. The gold sold by the Indian cultivators was called 'distressed gold'. That is they sold it because they were unable to meet their expenses from the produce of their land on account of falling agricultural prices. Gold was sold not for earning a profit but to tide over economic difficulties. It was also argued that the fixing of the exchange rate of Rupee at 1 S. 6 d. meant an over-valuation of it, which consequently led to an adverse balance of trade and gold

1. Prof. B.K. Adarkar, Dr. B.N. Kaul and others, whose articles supporting gold export from India were published in the Indian Journal of Economics of this period.

export. The opponents of gold export pleaded that as many countries of the world were trying to preserve gold, we should also have done the same. In fact, it was commercially a gain to Britain and a loss to India as the price of gold was continuously rising and Britain retained the gold imported from India for some time and then sold it at a profit.

After going through the above discussion, it will be clear that there was some force in the arguments given by both the sides. The agriculturists hoarded gold for tiding over their economic crisis and if they sold gold for that purpose at a time when the price of gold was high they did not suffer any harm. There was no harm in paying our external debts and other obligations in gold.

But gold export after a certain point was unjust, because it meant the Government's inactivity in curing the economic malady of the country. Gold was sold not for earning profit, but to tide over economic distress. It would have therefore been most appropriate for the Government to have checked a fall in agricultural prices and pushed up our exports by means of currency depreciation, or by bilateral or multilateral trade agreements after having encountered the shocks of depression in its initial years. The continuous fall in prices upto 1937 and the export of gold upto 1939 meant a prolonged hardship to the Indian agriculturists, who constitute the bulk of our population.
It also speaks of Government's indifference to their conditions.

**THE EXCHANGE RATE CONTROVERSY OF TERTIUS**

As already stated, within three days of Britain's going off the gold standard, the Indian rupee was linked with sterling at 1 s. 6 d. The rate of 1 s. 6 d. sterling to a rupee was considered to be the equilibrium rate by the Government and was supported by the supporters of Government policy. It was opposed by those who considered that by fixing the rupee at 1 s. 6 d., the Rupee was being overvalued and they pleaded in favour of the rate being fixed at 1 s. 4 d.

We shall first study the arguments in support of the official rate. It was stated that price index in India was not higher than that in U.K. - rather it was much lower - and as such it did not warrant any devaluation of the Rupee. Let us study the price indices of the two countries.

**TABLE - 8**

<table>
<thead>
<tr>
<th>Index Number of Prices in India and U.K. (1930 to 1938)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1929 = 100</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>U.K. (Board of Trade)</th>
<th>India (Calcutta)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1930</td>
<td>87.5</td>
<td>82.3</td>
</tr>
<tr>
<td>1931</td>
<td>76.8</td>
<td>68.1</td>
</tr>
<tr>
<td>1932</td>
<td>74.9</td>
<td>64.5</td>
</tr>
<tr>
<td>1933</td>
<td>75.0</td>
<td>61.7</td>
</tr>
<tr>
<td>1934</td>
<td>77.1</td>
<td>63.1</td>
</tr>
<tr>
<td>1935</td>
<td>77.9</td>
<td>64.5</td>
</tr>
<tr>
<td>1936</td>
<td>82.7</td>
<td>64.5</td>
</tr>
<tr>
<td>1937</td>
<td>95.2</td>
<td>72.3</td>
</tr>
<tr>
<td>1938</td>
<td>88.8</td>
<td>76.6</td>
</tr>
</tbody>
</table>

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1. Review of the Trade of India, 1939 - 40, p. 75.
From the above table it is clear that the internal value of the rupee was much higher than that of sterling in U.K. so that devaluation of the Rupee on this ground was out of question.

The lowering of the external value of the rupee to less than 1 s. 6 d. would have caused a rise in the prices of the imported goods and would have thus caused more hardship to the Indian consumers. The goods manufactured out of imported goods would also have been costly.

Lowering the rate of exchange of the Indian Rupee would have meant an additional burden on the Central and Provincial Governments in the shape of increased expenditure in their budgets. Because the foreign loan obligations of both the Governments - much of their pension obligations and the Home charges by the Central Government - were paid in sterling. A lower exchange rate of the Rupee at 1 s. 4 d. would have meant a bigger amount of Rupee expenditure in their budgets for the same amount of expenditure in sterling. This would have meant additional taxes on the already distressed peasantry.

The official support of 1 s. 6 d. rate was also based on the fact that the 1 s. 4 d. rate would have given an additional protection to the extent of 12½ per cent to the Indian industries. It was considered that such indiscriminate protection was not conducive to the healthy growth of
industries. Supporters of the exchange rate of 1 5. 6 d. further pleaded that the lowering of the exchange rate would have helped the speculators. It was therefore said that the Government had no intention of lowering the rate of exchange, and that it wanted to maintain it by all means. The most forceful argument against devaluation was that that was the period when most of the foreign trading powers had adopted tariff and other trade barriers against free imports and under such circumstances the devaluation of the Rupee to 1 5. 4 d. could hardly have stimulated our exports. On the contrary this policy on our part, could have given rise to further tightening of import control measures in those countries with whom we had trading relations. "On the whole it would appear that no lasting increase in our exports could be secured without a general revival of world demand for them. This in turn depended upon the relaxation of international tension and removal of barriers to international trade". 

Opponents of the rate of 1 5. 6 d. to the Rupee opposed it on the following grounds:

It was argued that the rate of 1 5. 6 d. to the Rupee meant an overvaluation of the rupee. Therefore, in order to maintain the overvalued exchange rate of the Rupee, the internal value of it had to be appreciated, consequently the

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1. Dr. Indra Nath Malhotra: History and Problems of Indian Currency, p. 56.
the general prices had to be kept at a lower level.

By keeping the internal prices low in the period between 1931 - 1939, the Government caused an untold hardship to the Indian agriculturists, whose income had fallen considerably. The obligations of the peasants on account of land revenue and debt charges etc., had to be met at the old rate whereas they could get lesser income from their produce which resulted in aggravation of their poverty. The protagonists of 1 s. 4 d. discounted the fear that the fixing of exchange rate at 1 s. 4 d. would increase the burden of expenditure to be paid in Sterling and also that of purchases of stores in U.K. It was estimated that an additional expenditure of Rs. 5 crores would be needed for meeting Sterling liabilities of the Provincial and Central Governments. The purchase price of stores would rise from Rs. 105 crores to Rs. 120 crores. Thus the additional burden would have been about Rs. 20 crores. Dr. B.N. Ganguly wrote, "It is unfortunate that the Government of India fail to recognise the expansionary effects of devaluation on exports as well as on imports and on the entire economy". ¹ Devaluation increases money incomes and there is an improvement in sales and business activity and if both internal and external trade is stimulated, it would more than compensate the loss suffered

¹ Dr. B.N. Ganguly: Whither Rupee? p. 148.
on account of devaluation by an increase in the incomes of
the government from taxes, custom duties, etc. "In the
case of Japan the statistical evidence indicated that as a
result of the depreciation of the Yen there was an increase
of 30 per cent in the peoples savings accumulated in the
various financial institutions, a 50 per cent increase in
output of staple manufactures, and a doubling of value of
exports and a gain of some 40 per cent each in the national
Railway freight traffic, bank clearances and factory empl oy-
ment". 1

The argument that 1 ½. 6 d. to the rupee was the
equilibrium rate was met by quoting the views of Dr. Keynes
on the fixation of exchange rates of currency. Dr. Keynes
had opined that there was no hard and fast rule by which one
can find out a permanent equilibrium rate of exchange between
two or more paper currency standards. "It has to be dis-
covered from time to time in the light of internal cost price
relations, profits, movements in terms of trade as reflected
in the index numbers of export and import prices, balance of
trade and gold movements on trade account". 2

We have now considered all the arguments for and
against the exchange rate being fixed at 1 ½. 6 d. to a Rupee.

1. Prof. Copland : Lessons of Monetary Experience, p. 394.
   Quoted by Dr. A.N. Ganguly - Whither Rupee? p. 148.
2. Dr. J.M. Keynes : The Future of Foreign Exchange, N. Y. coda
In a nutshell it can be stated that all the economic ills of India in the thirties could not be cured by lowering the rate of exchange alone. The ills were due to a general condition of economic depression in the world. Devaluation could have been one of the instruments in bringing about recovery in the Indian economy, but it could never have been the sole panacea for the economic illness. The economic depression in India needed many other remedies along with the measure of lowering exchange rate of the Rupee. The depression in U.S.A. and U.K. was counteracted by a number of combined economic measures like cheap money policy, Public works programmes, Multilateral trade agreements, etc. Writing in favour of the lowering of the exchange rate to 1 s. 4 d.

Dr. Malhotra himself admits that the devaluation of rupee could give only a temporary stimulus to prices and that for permanent results remedies of other kind, which would increase productive efficiency and lower cost of production, must be applied.¹

¹ To far as the distress of the Indian agriculturist is concerned — due to a fall in the prices of his products — it may be said that the Government took no action to relieve him of his distress. No price support was given to agricultural products. The Government should have adopted such a

¹ Dr. L.K. Malhotra : History and problems of Indian Currency, p. 88.
policy even at the cost of some loss to its revenues. With the fall in the prices of his products, the Indian cultivator was getting more and more burdened with debt and his savings in gold started flowing out of the country, through the bullion dealers of India to U.K.

THE RESERVE BANK OF INDIA

The Hilton Young Commission in 1926, had recommended the establishment of a Central Bank for India. The Reserve Bank of India Act was passed in 1934 and the Reserve Bank of India was established on April 1, 1935. Prior to the establishment of the Reserve Bank, the Government of India issued notes and credit control was the responsibility of the Imperial Bank of India. According to the preamble of the Reserve Bank of India Act 1934, the main functions of the Bank is "to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage". 1

The Reserve Bank had a fully subscribed capital of 4.5 crores divided into shares of £10/- each. Its management was entrusted to a Central Board of sixteen Directors.

The appointment of the Governor, two Deputy Governors and one more director was made by the Governor General in Council. Five local boards were also constituted. The Reserve Bank has two Departments — Issue Department and Banking Department. The assets and liabilities accounts of the two departments were to be kept separately.

The note-issue work was entrusted to the Issue Department. The liabilities of the Issue Department consisted of the notes issued by it from time to time. The assets to be held as Reserves for notes issued were to be in gold bullion, gold coin, Sterling securities, rupee coins, rupee securities and bills of exchange and promissory notes. Of the total amount of assets at least 40 per cent was to be in gold bullion, gold coin and Sterling securities. It was also laid down that at no time the Reserve of gold bullion and coin should fall below 40 crores at 21-7-10 p. per tala. The Bank took over the whole of the gold coins and gold bullion in the Gold Standard and Paper Currency Reserve and also took over the liability in regard to the notes which were previously issued by the Government.

The Banking Department of the Reserve Bank was entrusted with the banking functions of a Central Bank. The Reserve Bank had to accept money and make payments on behalf of the Secretary of States and the Central and Provincial Governments. It was also to perform banking and foreign
exchange transactions for them. The Reserve Bank in terms of Section 17 (5) of the Act was authorised to give short-term advances for a period not exceeding three months to Central and Provincial Governments, local bodies, scheduled banks and State Co-operative Societies. The Reserve Bank pays interest neither on the deposits that it receives on behalf of the Central and Provincial Governments nor on private deposits and the deposits the commercial banks maintain with it. The scheduled banks are under compulsion to deposit certain percentage of time and demand liabilities with the Reserve Bank.

The Reserve Bank was also authorised to undertake open market operations for stabilising the market value of Government securities and for regulating the supply of currency according to the needs of country's economy.

The Rupee - Sterling rate was fixed at 1 s. 6 d. in 1927 and it is the same even today. The task of maintaining the Rupee - Sterling rate at 1 s. 6 d. was entrusted to the Reserve Bank. The Reserve Bank is the sole custodian of our foreign exchange. Section 40 of the Reserve Bank of India Act reads as follows: "The Bank shall sell or buy from any authorised person who makes a demand in that behalf at its office in Bombay, Calcutta or Madras. . . . foreign exchange at such rates of exchange and on such conditions as the Central Government may from time to time by general or
special order may determine'.

The Reserve Bank was to act as a banker to the Commercial banks. They keep their deposits with the Bank. The scheduled banks have been keeping a proportion of their time and demand deposits with the Bank as a matter of legal binding. The scheduled banks are protected at the time of their difficulties by the Reserve Bank. The clearing House of the commercial banks operates through the Reserve Bank but in the places where there is no branch of the Bank, the State Bank of India (formerly Imperial Bank of India) performs this function as an agent of the Reserve Bank.

The Reserve Bank has also an agricultural credit Department. This Department helps the State Co-operative Societies and Land Mortgage Banks with long term loans. The Department also helps the co-operative societies to train their workers and advises the Government on Rural Finance.

With the outbreak of war in September, 1939, exchange Control Act was passed in India and the Exchange Control Department of the Reserve Bank was entrusted with task of administering the various provisions of the Act. On the 4th September, 1939, the Reserve Bank issued an explanatory memorandum about the Exchange Control Act. It stated, "The policy regarding exchange control was to ensure that all

Foreign exchange transactions in India were done on the basis of rates quoted by the London Exchange Control combined with the current rupee rate for sterling. Authorised dealers in foreign exchange were informed that no business must be done by them outside this rate.¹

The following restrictions were imposed on the Reserve Bank. The Bank was not to take part in any industry or trade nor to start them. The Bank was not permitted to advance loans on the security of immovable property nor was it allowed to purchase them. It was not authorised to purchase its own shares nor those of any other bank. The Bank was not to accept any securities other than demand paper. It was debarred from paying any interest on its deposits nor could it advance unsecured loans.