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THE PROBLEM OF THE STANDARD OF INDIAN CURRENCY

A. Sadeque

AN ABSTRACT OF THE THESIS

This study examines the development of monetary management in India from 1873 to date, with special reference to the objectives or standards to which such management has tried to conform. During this period, economic opinion about monetary objectives has undergone revolutionary changes. During the firs fifty years, the maintenance of a stable exchange rate through gold standard mechanism was the objective. During the nineteen-thirties, internal stability at a high level of economic activit and employment became the aim of currency management. In the present decade, the maintenance of a stable international currer relation and internal full employment are both regarded as objectives. The introductory chapter of this study reviews the development of this evolution.

Monetary management is fundamentally an international activi though different countries play unequal parts in it. The genera course of management has been regulated, for all, by the major economies of the world, or, more correctly, by England before World War I, and after it by England, U.S.A., Germany and France The function of smaller countries has been one of adaptation. Monetary management in the major economies has thus automaticall constituted the main part of the monetary management in a minor economy like India. The indigenous aspect of Indian currency management has been the secondary function of adaptation to the international framework devised abroad.

Consequently, an analysis of the international gold standard of the fifty years, and of the attempts of the Indian management to adjust its system to the international standard, constitutes the subject-matter of Chapters II and III. Chapter I analyses the currency warfare of the thirties resulting from the efforts of the major economies to assume domestic currency auton and its repercussions on Indian currency management. The last tw chapters (V and VI) examine the problems of Indian currency management in the present decade, when the maintenance of an equ -brium exchange rate fixed by the international agreement embodi in the Bretton Woods system, and of internal full employment, sh form the monetary objectives of India.

The speciality of this study lies in the internation perspective of Indian currency management, in its attempts to lo India's real position in the international monetary set-up durin the period under review and in its prescribing the external curr relation which India should maintain in the immediate future. Th examination of the extent to which the internal monetary objecti of full employment investment may be pursued in India, in this international set-up, is another contribution of this enquiry.

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for the Internal Ph.D. Degree,
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Abdus Sadeque.

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C H A P T E R I .

INTRODUCTION

Section I. The Scope of the Enquiry.

The purpose of this enquiry is to examine the development of monetary management in India during the last threequarters of a century with special reference to the objectives or standards to which such management consciously or unconsciously, tried to conform. The significant point in this connection is the fact that during the period under discussion, the consensus of opinion about the very objective of monetary policy has twice undergone fundamental changes. During the first fifty years of this period, the International Gold Standard held the field and a country was expected to maintain a stable exchange rate through the gold standard mechanism. The purpose for which a stable exchange was maintained was a high level of international trade. During the 1930's autonomous national currencies came into vogue. The stimulation of economic activity was recognised as the main objective of Monetary management and a national currency was considered a means to that end. During the present decade of the 1940's, a synthesis of both objectives has been attempted. The maintenance of a stable international currency relationship for a high level of international trade and an internal full employment policy have become the simultaneous objectives of currency policies of most countri

These changes in monetary objectives, from the regulation of money in accordance with almost the natural laws of the gold standard, to the detailed management of modern times, represent a continuous evolution of monetary ideas for a much better ordering of the economic activities of the world. Money is simply a means to securing a desired order of economic activities and it does that by facilitating exchange. Most economic activities are organized on the basis of private property, division of labour and exchange. Exchange means interchange of goods and services, produced or owned by different persons in accordance with the ownership of property and division of labour. But exchange of goods requires a comparison of the value of each thing with the values of all others. It is impossible to compare the values of all things unless the value of each thing is expressible in terms of one common denominator or measure of value. The first requirement of a society based on the division of labour and private property is to have a common measure or standard of value which will acquaint one with the relative values of all things and will facilitate the exchange of one commodity against another.

Not only to facilitate exchange by helping the ascertainment of relative values, but also to dispense with the awkwardness of barter altogether, it is necessary to have a representative of the standard of value which will be accepted by all in exchange for their goods. It is absurd to think that the desires of persons bartering goods will coincide in identical terms as regards kind, quality, quantity and value. When a representative of the

standard of value or money-proper is adopted, this difficulty of establishing a double coincidence of desiderata is obviated. A person sells his surplus goods for money and with that money he purchases the things he needs. In this case, money serves as a medium of exchange. By this division of the process, each part of the indirect exchange or monetary transaction is made independent and expedited. By thus facilitating exchange, money has made the division of labour and the modern system of production possible.

Money is put into circulation and made to serve as the medium of exchange by two sets of persons who may be said to constitute the demand and supply sides of money. The supply of money comes from a composite group of persons and institutions comprising the Central Bank and the Government of the country who issue the currencies and the ordinary banks and savers who hold money as loanable funds. The demand for money is offered by entrepreneurs and others who generally invest money for productive purposes. The volume of money in circulation, therefore, depends on the action and reaction of these demand and supply forces and may be said to be the product of the physical quantity of money and its velocity of circulation. The volume of money used in exchange is thus the same thing as expenditure in a given period of time. As the expenditure of some is necessarily the income of others, the former automatically determines the latter. The bulk of the income of the people, particularly of the working classes, is used to purchase consumption goods and thereby constitutes the effective demand of the society. Hence the action of the entrepreneurs and bankers, by regulating expenditure and income of the society,

determines also its effective demand for goods.

Again, bankers and entrepreneurs, by regulating the volume of money and thereby exchange and division of labour on the one hand and effective demand on the other, necessarily determines the level of economic activity of the society at a given period of time. When, for example, the entrepreneurs are very optimistic about the profitability of their prospective investments and the bankers are also inclined to follow an easy money policy, the volume of loans and investment expenditure may increase to the level at which all the available factors of production are fully employed. At other time pessimism of the entrepreneurs and bankers by restricting exchange and division of labour on the one hand and curtailing effective demand on the other, may keep economic activity at a low level and thereby render some factors of production unemployed.

It is thus obvious that by regulating the conditions of demand for and supply of money it is possible to adjust the volume of expenditure and effective demand to such a level as to attain the fullest utilization of all the available factors of production. The regulation of the volume of effective demand, to level up economic activity to its potential maximum, was not considered to be a concern of monetary management upto the twenties of this century. But, nowadays, monetary management not only aims at stimulating effective demand for maximising economic activity, but it aims at it, not on a national, but on an international scale, so that the advantages of international division of labour can be secured at the same time. This comprehensive aim of monetary management has been the climax of the development of monetary theories and practice during the last seventy five years. The remaining part of this

introductory chapter gives a summary account of this evolution of monetary management.

Section 2. The objective of Monetary Management from 1873 to 1914.

The Monetary supplies of the different countries of the world from 1873 to 1914 were regulated in accordance with the rules of the International Gold Standard system. The increase and decrease of the supply of money in strict proportion to the increase or decrease of the gold reserves of a country were considered to be the essence of the gold standard rules (1). Ordinary banks had to keep a minimum ratio of cash reserves with themselves and/or in their accounts with the Central Bank, against their deposit liabilities. When they extended their loans very freely and their cash reserves fell below the legal or conventional minimum, they replenished those reserves by taking fresh loans from the Central Bank. As the loans granted by the Central Bank became its own deposits, it was able to grant loans almost indefinitely. But the Central Bank itself was obliged to maintain a legal minimum of cash reserves against its liabilities, and its minimum ratio was far higher than the minimum reserve requirements of other banks. Thus, when the Central Bank's liabilities were already touching the maximum limit, it could not extend further loans to other banks when the latter wanted to lend more than what their existing reserves permitted. The Central Bank's reserves, therefore, constituted the ultimate limit of the loan-making power of the banking community of the country. Under the gold standard regime, the reserves of the Central Bank consisted of gold or foreign exchange convertible into gold. The volume of this reserve of the central Bank depended

(1) " International Currency Experience", by the League of Nations, 1944, p. 66.

~~pended~~ on the exigencies of the balance of payments situation. If the balance of payments of the country was favourable, there followed a net import of gold into the country, increasing thereby the reserves of the Central Bank, which could, and did, extend loans more freely to its scheduled banks. In the reverse case, when the balance of payments was unfavourable, there ensued a net export of gold from the country, reducing thereby the reserves of the Central Bank which had to recall a part of the advances made to its scheduled banks. The latter were, in turn, compelled to reduce their advances to their own clients. Thus the import and export of gold led the banks to make a multiple increase or decrease in the money supply of the country. The balance of payments situation of a country, therefore, regulated its gold movements and the monetary authority, by observing the rules of the gold standard game, regulated the volume of money on the basis of its gold holdings.

The obvious purpose of the observance of the gold standard rules by a country was to maintain its balance of payments equilibrium. When a country had an unfavourable balance of payments and lost gold in consequence, the price-level in that country was lowered and this, in turn, reduced employment, investment and income in the society. The reduction in the price-level lowered the prices of its exports in foreign markets and thereby stimulated exports, while the fall in employment and income lowered the purchasing power of the inhabitants of that country and, in consequence, the import of foreign goods. Rise in exports and fall in imports went on improving the balance of payments of the country till

equilibrium was reached and the gold export was stopped. The attainment of this equilibrium was hastened by the opposite effects in the gold receiving country.

The balance of payments equilibrium was necessary for providing the means of payment for the foreign purchases of a country. The gold reserves of countries were not generally sufficiently great to enable them to liquidate their unfavourable balances by shipment of gold only. Ordinarily, only negligible proportions, if any at all, of unfavourable balances were met by gold exports while the main part, if not the whole of an unfavourable balance, was corrected by an increase of exports and a decrease of imports. Thus, the proceeds of sales of all kinds to foreign countries provided the means by which the payments for foreign purchases were made. When purchase from foreign countries became greater in value than the total sales to foreign countries, the international trade of the country concerned was blocked by the scarcity of the means of foreign payment. On the other hand, when sales to foreign countries stood permanently in excess of purchases from foreign countries, foreign trade was choked by the inability of the foreigners to meet their obligations. Thus,the position of equality between foreign purchase and sale not only provided the means of payment of international trade, but also tended to maximise the volume of foreign trade of the country at a given level of economic activity.

It is,therefore, obvious that the gold standard , by always maintaining the balance of payments equilibrium could claim to its credit a high level of international trade for

each country. There were, however, other methods of maintaining balance of payments equilibrium without observing gold standard rules. When one country bought goods from another, it had to exchange its domestic money for foreign money to make payment for its purchases. The exporters of goods to foreign countries were paid in terms of foreign currencies, which they sold to domestic importers of foreign goods in terms of domestic money and the importers paid the foreigners in their own currencies. Foreign currencies thus bought and sold in the foreign exchange market of every country became known as foreign exchange. The price of foreign currencies in terms of domestic money were termed foreign exchange rates. The amount of foreign money which the buyers (importers) were willing to buy became greater, when the price of foreign money in terms of domestic money became lower. This cheapening of foreign money made all foreign goods cheaper and more of them were bought by importers. To pay the price of these increased foreign purchases, importers became eager to purchase more foreign exchange. A higher price for foreign bills, on the other hand, increased the prices of foreign goods all round to domestic buyers, importers were willing to import less and their demand for foreign money decreased. The amount of foreign money supplied in the foreign exchange market varied with the price paid for foreign money in terms of domestic money. When an exporter received more domestic money for his foreign bills, his profit from export increased. He was stimulated to increase exports to augment his profits; and this increased export increased the volume of foreign ex-

change in its exchange market. In the reverse case, when the price of foreign bills fell, the exporters suffered losses, curtailed their exports and reduced the volume of foreign exchange in the domestic market. The ultimate exchange rate was determined at a point where demand for, and supply of, foreign bills equilibrated. The equilibrium in the balance of payments was thus brought about by the fluctuations in the exchange rates, whose specific function was to bring about the adjustment of foreign purchases and sales.

The system of freely fluctuating exchange rates could, therefore, be considered as an alternative method to the gold standard to maintain the balance of payments equilibrium of a country. But, if fluctuations in exchange rates were allowed a free scope, international transactions were bound to be very seriously hampered. Any change in its exchange rate would automatically lead to changes in all the import and export prices of a country. The effects of changes in the exchange rate would not stop with changes in prices but would also affect the volume of production of imported and exported goods (and securities) which would thus be subjected to a constant flux. A substantial fall in the exchange rate might ruin the very important export industries of a country, though it would make imports very much cheaper. But, if relying on cheap imports, corresponding domestic industries were given up, the country concerned might be deprived of those commodities altogether by a rise in the exchange rate, a short while after. Thus, under fluctuating exchanges both the export and import industries of a country

would become extremely risky. This risk element was bound to reduce international transactions to the minimum and whatever international transactions were to be carried on, would be reduced to bilateral barter, to mitigate the risk as far as possible. A stable exchange rate was, therefore, an essential prerequisite for a high level of international trade.

Both stable exchange rates and balance of payments equilibrium were thus found to be equally essential for a high level of international trade, but they would go ill together and were obviously contradictory, because the sacrifice of the one was the means of attaining the other. If equilibrium in the balance of payments was maintained, exchange rates would fluctuate and, if on the other hand, exchange rates were kept stable, the balance of payments was bound to suffer. It is at this point that the service of the gold standard lay, because the system maintained the balance of payments equilibrium without more than nominal fluctuations (within gold points) in the exchange rate. In fact, stability of exchange rates was the fundamental characteristic of the International Gold Standard system.

Thus, the rationale of the observance of the gold standared rules lay in the very necessity of having any international trade at all. It is a well-known fact that the different countries of the world are endowed with different natural resources and their peoples have attained different grades of industrial training; in consequence, international trade would confer immense advantages arising from both geographical

and international division of labour. In fact, the attainment of these advantages of international trade was the only raison d'être of the International Gold Standard system.

But the maintenance of the gold standard necessitated a fairly heavy sacrifice. When a country under the gold standard system suffered from an unfavourable balance of payments, it was obliged to export gold and to reduce its credit circulation at a multiple rate, which, in turn, reduced its price-level. Declining prices reduced profitability of investments and thereby investments themselves. When the entrepreneurs diminished their investments, they diminished simultaneously the volume of employment and income of the society. In the reverse case, when a country had a favourable balance of payments, it increased its prices, employment and income. Thus, the gold standard countries maintained their balance of payments equilibrium at stable exchange rates by constantly fluctuating the level of their internal economic activities. This involved heavy frictional losses in the constant shifts of export and import industries of a country and immense human suffering in the occasional losses of employment and income. Nevertheless, the attainment of the advantages of international trade by observing the gold standard rules regardless of their effects on the level of internal economic activity was the recognised objective of monetary management in the different countries of the world till the First World War intervened and smashed the gold standard system.

Section 3: The Objectives of Monetary Management from 1914 to 1931.

The maintenance of a high level of international trade was not only supposed to be the main objective of monetary management, but people were not even conscious before World War I that money could, or should, be managed to attain any other objective. When the International Gold Standard system broke down under the impact of the war, there emerged autonomous national currencies consisting of inconvertible paper moneys. A good part of war expenditures in the belligerent countries was financed by printing of currency notes. Though excessive issues of paper money led to inflationary tendencies in many cases yet it attained the main purpose of commandeering economic resources for war purposes. In some cases it put unemployed labour and capital in to the production of war materials, while in other cases it diverted ecohomic resources from the production of civilian consumption goods to that of war supplies. War finance thus demonstrated that the supply of money could not only be increased almost indefinitely without any reference to gold reserves, but this increased money had the same power as the pre-existing money to commandeer economic resources for a set purpose.

On the termination of the war, a movement was set afoot to manage the monetary systems of the different countries with the object of stabilising their economic activities. This new trend of thought advocated the non-restoration of the International Gold Standard and dubbed it a barbarous

relic. "All of us," declared J.M.Keynes in 1923, "from the Governor of the Bank of England downwards, are now primarily interested in preserving the stability of business, prices and employment and are not likely when the choice is forced on us, deliberately to sacrifice these to outworn dogmas." (1) The exponents of this school of thought wanted to maintain the level of economic activity of the different countries undiminished, by utilizing the newly discovered power of manoeuvring the supply of money without any reference to gold reserves.

It was, no doubt, true that excessive supplies of paper money during the war created a measure of inflation which did not stop even after the suspension of hostilities. Many indigent governments of war-torn Europe continued to increase the supply of their paper money to run their tottering administrations. In some cases the increased supply of money and consequent inflation were so excessive that their currencies were ruined. These practices caused inconvertible paper moneys to be generally discredited but, nevertheless, the extreme elasticity of the supply of money - even maintaining its convertibility in gold - was not lost sight of. Not only currency notes, but cheque-money as well, could be expanded to almost any degree to meet the demand for any high level of economic activity of a society. It was not for the metallic content that a person accepted money - a currency note had no metallic content. It was not for a government fiat that money was accepted - a cheque had no fiat, it was simply an optional

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(1) "A Tract on Monetary Reform", by J.M.Keynes, 1923. Ch.4.

money. People accepted a currency note and a cheque quite readily because they could make purchases with them as with metallic coins and, at the same time, paper money was more handy to use and cheaper to issue. Paper money that was ordinarily accepted in exchange for goods was simply an I.O.U. A currency-note, for example, was a 'promise to pay' by the Central Bank of the country. A cheque was also a 'promise to pay' by the drawer of the cheque as well as the bank on which it was drawn. The important point in this connection lay in the fact that, if mere I.O.U.'s could acquire general purchasing power and become money, obviously there could be any amount of such I.O.U.'s to finance people to any extent.

In fact, a banking community with a Central Bank at its apex need not have felt any limit to its money-making power, except its own judgement. The ordinary cheque-paying banks could take advantage of the banking habit of modern people of keeping their cash balances, not with themselves, but with banks as deposits and could thereby create any amount of money by simply lending deposits to borrowers. Borrowers voluntarily took loans in the form of deposits which were then transferred to the accounts of persons from whom the former made their purchases. When the sellers spent their money, the deposits were transferred once again in the banks' books to other accounts. In this way, deposit was transferred from person to person till it came to the credit of the savers where it found a resting place. Deposits with a bank were clearly its debts to the holders of such deposits and as a bank created these deposits by simply advancing money to bor-

rowers, it seemed to possess power to create I.O.U.'s of a deposit-money type, to any extent.

Although a bank could create deposit-money to any extent, yet the money thus created did not belong to the bank. Every depositor with a bank was its creditor to the extent of his deposit which was consequential to a loan granted by the bank to a borrower. In other words, the bank was simply the intermediary between the depositor and the borrower. But the peculiarity of the transaction lay in the fact that the depositor was under the impression that his money was with the bank while the bank had already lent his money, not only without his knowledge, but also without his permission and in anticipation of his deposit forthcoming. As deposits ultimately passed to the credit of the savers, banking might be considered as a device for lending savers' money to borrowers without the savers' knowledge and consent and often in anticipation of their saving. This power of the banks to manipulate other's money appeared like that of creating money out of nothing.

This money-making power of a bank was limited by the fact that all the probable receivers of cheques or deposit money might not be the bank's own clients. Loans granted by one bank might result not in its own deposits, but in the deposits of another bank. Though the mutual demands of the different banks on behalf of their clients' deposits might just balance, there were possibilities of inter-bank inequalities of demand. But these inequalities could be very easily adjusted if there existed a Central Bank to act as a clearing house.

If in place of one bank, we assume a banking system with a Central Bank at its apex, its deposit-making power would be extremely elastic.

Again, people converted a certain part of their deposits into cash because some transactions could be more conveniently done by cash or legal tender money. The banks were, therefore, obliged to keep a corresponding reserve in legal tender money to meet such demands. But as cash transactions of this type constituted a small proportion of the total transactions, the reserve requirements of the bank for this purpose were quite low. In England, for example, 10% was the usual figure taken for safety's sake and the banks could extend loans to the extent of ten times their reserves. Thus, the bulk of the money that effected transactions in an advanced community was deposit-money uncovered by any cash and created and safeguarded by securities representing the titles to real goods and properties exchanged. As long as there were genuine transactions in goods and real properties, these could be effected by deposit-money based on the confidence of the public in their banks.

The 10% reserve which the banks generally kept need not have been gold reserves. Legal tender money consisting of overvalued coins of base metals or currency notes could as well serve this purpose. For internal purposes, therefore, gold reserves were not at all necessary. The confidence of the public on which the bulk of the deposit money depended, might, however, be shaken on occasions and a run on banks might develop. In such crises, banks would be obliged to

take loans from the Central Bank of the country in terms of legal tender notes, and cheque money would be replaced by currency notes. Notes and deposits, however, were simply different types of loan deeds to humour the different preferences of savers. Taking the issuers of cheques and notes as a composite monetary authority, it seemed that the confidence of the public in their monetary authority was extremely great and on that basis the latter could issue loans and increase the supply of money to any desired extent.

Now, if the monetary authority of a country freely extended loans on easy terms to the entrepreneurs, the latter would extend their scale of production and would thereby increase the employment and income of the society. By withholding and stiffening the terms of loans, the monetary authorities could compel the entrepreneurs to curtail their scale of production and thereby reduce the employment and income of the society. By adjusting their loan policy, the monetary authority could, therefore, maintain a stable level of economic activity of a society, and this was what J.M.Keynes and other exponents of the new school of thought after World War I wanted the monetary authority to do. This new ideal of monetary management was epitomised in the development and perfection of the Central Banking theory in the twenties, which specifically assigned to the Central Bank the task of stabilising the level of productive activity of its society.

But the supporters of the old system wanted to restore the gold standard in the pre-war form and to continue monetary

management with the old objective of a high level of international trade. They not only succeeded in rehabilitating the International Gold Standard by 1925, but they also carved out a place for their gold standard in the perfected theory of Central Banking. In addition to the maintenance of the internal productive stability of its country, the Central Bank was also required to maintain its external stability. That is, the Central Bank was to be the keeper of the national gold reserve and had to maintain the balance of payments equilibrium of the country. Simultaneous attainment of both internal and external stability was thus made the objectives of monetary management in the twenties.

The basic incongruity of the two ideals was either misunderstood or deliberately overlooked. The monetary authorities were required to observe gold standard rules as well as to maintain internal productive activity, but in practice they could not do either effectively. Often the two ideals were in open conflict. The countries having favourable balance of payments could not allow the consequential gold imports to exert their full influence on prices, employment and investment because that involved a dislocation of domestic economic activity. Gold imports, therefore, began to be increasingly neutralised. In U.S.A., neutralisation of gold was pushed to such an extent that the world value of gold was made to keep parity with the value of the U.S. dollar. Gold movements practically ceased to have any influence on the fortunes of American investment, employment and price-level. Similarly France accumulated a huge supply of gold, second

only to that of U.S.A., but its effect on the French price-level was very slight. On the other hand, countries, such as Great Britain, which had unfavourable balances of payments, were not either willing or able to reduce their cost of production or employment to the desired extent to restore their balance of payments equilibrium, because that involved a dislocation in their internal economy. Thus, the currency system operated in a manner that deviated a good deal from a model gold standard. The deficit balances of many countries went on increasing and were destined to bring about a crash sooner or later.

On the other hand, monetary authorities could not effectively maintain their internal economic stability because it clashed with their observance of gold standard rules. An internally generated crisis in 1929 brought about a complete collapse of the American import market, and confronted most of the countries of the world with sharply deteriorating deficit balances of payments. As their gold reserves were required to the fullest extent to protect the gold standard, they could not expand their money supply to arrest the deterioration of internal economic activity. Thus in 1931, not only the gold standard broke down, but all the countries were at the lowest level of depression. Both international trade and domestic productivity sank very low and were on the downward grade.

Section 4: Monetary Management from 1931 to 1936.

The American crisis of 1929, by creating acute balance of payments difficulties in many countries and drying up their gold reserves, finally broke down the International Gold Standard system in 1931. The gold standard was thus revealed as a fine-weather-craft which could function easily in a period of prosperity, but was almost certain to collapse if a crisis developed in any of the major import markets of the world. The management of money in accordance with the gold standard rules, so as to have a high level of international trade, was thus found to be associated with a sinister function which was capable of disorganizing the productive activities of all the countries of the world and bringing acute distress to all in periods of depression. Not only was internal economic activity reduced by the depression, but international trade itself was diminished to abnormally low figures. The depression, therefore, not only broke down the gold standard, but also discredited it as a mechanism to maintain consistently a high level of international trade. This, in turn, led to the discarding of the very ideal for which the gold standard stood, simply because it was unattainable. Thus, with the liquidation of the gold standard in the early thirties, the attempt to regulate money to attain a high level of international trade was given up by most of the countries of the world. Attention was thenceforward concentrated in the maintenance of internal economic activity only.

But the pursuit of a policy of internal stability was also found to be fraught with serious complications. It

had long been thought (as, indeed, was borne out by the condition of the prosperity-boom in the twenties) that the monetary authorities by simply increasing the volume of loans to the entrepreneurs could correspondingly increase investments, employment and saving of the society. During the depression the inability of Great Britain and other deficit countries to expand loans (due to the drying up of their reserves) could, therefore, be assumed to be the cause why their internal productive activity could not be maintained. After the de-linking of the sterling from gold in 1931, Great Britain adopted an easy money policy and her antrepreneurs availed themselves of this opportunity to inaugurate an expansionary programme which continued throughout the thirties. But the situation was fundamentally different in other countries and particularly in surplus countries such as U.S.A. where the virulence of depression was particularly acute.

In 1929, U.S.A. had a huge gold reserve and, after the onset of the depression, her favourable balance expanded and her reserves were strengthened. There was, therefore, no difficulty on her part in adopting a policy of cheap money and thus, as was thought, maintaining the internal economic activity from the very beginning of the depression. But the real difficulty was that the American entrepreneurs became completely impervious to any cheap money policy. They were not willing to borrow money on any conditions and were not in a mood to undertake any investments whatsoever. It was then found that the extension of loans did not depend on the monetary authority alone. Unless borrowers were forthcoming to take loans, the monetary author-

ity could not expand loans by its unilateral efforts. The entrepr
eneurs, who were so long supposed to be willing to borrow any
amount of money which banks were ready to lend, were found to be
unable to maintain a steady demand for money. The analysis of the
causes of entrepreneurial borrowing and private investment, as
well as the trade cyclical theory that tried to explain the forme
phenomenon, drew marked attention from all. Increased discussions
on the cyclical theory, supplemented by a wealth of recent experi
ence of the prosperity-boom of the twenties, gave a perfection an
clarity of view to the theory which it never before possessed.

Private investments were observed to follow a cyclical patt-
ern. At times entrepreneurs became feverishly active as a class
and went on borrowing and investing until a high peak of employ-
ment and production was reached. From this peak a recession began
after a sudden outbreak of business failures. From that level
production and employment sank to their lowest depth, only to
rise once again.

The periodicity of depression and prosperity was caused by
several factors. During the depression, an economy, almost as a
matter of course, came to have unemployed labour and capital on
the one hand and accumulating replacement demand and potential
innovations, providing good investment propositions on the other
As a result of the combination of these forces, investment reviv-
ed again sooner or later. With the increase of investment, the
income of the people went on increasing and the increased income
augmented the demand for consumption goods. The greater demand
for consumption increased, in turn, the demand for capital goods.
This justi-

fied the previous investments and stimulated further investments and the spiralling up of demand for consumption goods, income and investment continued until all the unemployed factors of production were fully employed.

In the upswing of income and investment, certain disproportionalities in investment occurred almost automatically.(1) Even after the beginning of the revival, the low rate of interest continued for some time more and tended to increase the value of capital goods at an accelerated rate while the value of consumption goods increased pari passu with income but without any acceleration. Moreover, investment in capital goods took a much longer time to increase their supply and thereby to influence their price than was the case with consumption goods. During this whole period when the increased demand for capital goods could not be satisfied due to their non-completion in a serviceable form, investment in capital goods industries continued at an accelerated rate until too much capital investment was effected. At full employment level it was thus found that investment in capital goods industries was much greater than the demand for capital goods (that is, the volume of spontaneous saving) at that level while the demand for consumption goods was greater than their supply. Moreover, once the maladjusted investments were undertaken, they could not be corrected by transferring some investment from capital goods industries to consumption goods industries. The suspension of the production of capital goods industries before

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(1) "Prosperity Decade: A Chapter from American Economic History 1917-1929," by George Soule, 1947. pp.275-288.

a technical point of completion, involved a dead loss on all the previous expenditure on that line. On the other hand, once completed, it was unthinkable to transfer it to other uses. To convert a cotton-loom producing plant into a cotton-loom, meant scrapping the plant itself and writing it off as a dead loss.

As the supply of capital goods became greater than the demand for them at full employment, their prices began to fall and the producers thereof found themselves in great difficulties. When the producers' assets decreased in value, the banks began to refuse them further accommodation and even began to recall the loans already advanced. This necessarily led to business failures and the banks were scared and raised their interest rates to prohibitive heights. The rise in interest rates reduced the value of capital goods at a precipitous rate and caused investment in capital goods to be suspended completely. Reduction of employment led to a shrinking of production and income. The consequent diminution of effective demand, in the face of a supply that in some cases was still increasing, led to a sharp fall in prices. The declining cycle of investment, income and prices continued until the rock-bottom of depression was reached.

Over and above these almost mechanical causes of fluctuations in entrepreneurial investment, probably it was in their very nature that private entrepreneurs did suffer from occasional spasms of bearishness and bullishness. Bearishness, that led to a deficiency in private investment, origin-

ated from the entrepreneur's anticipation of a consumption demand which was insufficient to give full employment. But deficient investment resulting from this anticipation of deficiency, made consumption demand still more deficient because many men were rendered unemployed and without incomes. The entrepreneurial anticipation was thus materialised and they reduced their investment all the more. Once the spiral was on, it was not possible for the entrepreneurs to get out of that vicious circle. Only if the government undertook investment in the face of the prevailing trend of bearishness, increased demand stimulated by government investment expenditure would begin to increase the profitability of investment and would ultimately reverse the trend of bearishness altogether. In the case of extreme bullishness of private investment expenditure, a deliberate curtailing of government investment expenditure would reduce private income and would curb the bullishness of private entrepreneurs. Thus, fluctuations in private investment could be eliminated by the government if it always stood ready to make up the deficit in private investment whenever the latter showed any tendency to slacken.

It was thus apparent that what was needed was not only a consistent easy money policy by the monetary authority, but also a compensatory investment policy either undertaken or subvented by the government to maintain a stable demand for money. During the first half of the thirties, most of the leading countries of the world adopted an anti-cyclical pol-

icy of stimulating domestic economic activity, by regulating both demand for and supply of money - particularly the former - to extricate their economies from the clutches of the Great Depression. On the supply side, the cheap money policy was the main device adopted. The low rate of interest was expected to lower the cost of production of the entrepreneurs and to increase the profitability of investment. The novelty of the measure lay in the fact that under the gold standard regime interest rate could be lowered only when the reserve position was strong and improving. The gold reserves of U.S.A. were very big and she could afford to adopt a low interest policy. But the situation in Great Britain and Germany was exactly the reverse and under orthodox finance they had to raise their rates of interest. But in all these countries a low interest policy was followed, showing thereby that it was motivated by desires of recovery irrespective of the reserve position of the countries concerned.

On the demand side, attempts were made to increase the purchasing power of consumers, either by direct distribution of relief among the distressed, or by direct undertaking of investments by the governments which increased the income of the employees and thereby their purchasing power. This increased purchasing power (or demand) stimulated economic activity and production and thereby tended to reverse the trend of depression. Due to various favourable circumstances, Great Britain was not in need of supplementing her demand by any such measures. But in U.S.A. and Germany the intensity of depression necessitated a vigorous application of these

demand-stimulating-measures. In U.S.A. the miseries of some sections of the unemployed were so great that the government had to provide relief on an extensive scale with money borrowed from the Federal Reserve Banks. Huge public works were also undertaken primarily to distribute relief rather than to create employment, or increase production. All these measures, directly and indirectly, stimulated the effective demand of the country which could not but give a fillip to her productive activity. Unfortunately, the fall in investment expenditure of the local governments during the same period neutralised the demand-stimulating-effect of a part of the central government's expenditure. Public investment in Germany, particularly as a part of the rearmament programme, increased demand to such an extent that it ran ahead of production even at full employment level. Recovery attained by these measures varied from moderate prosperity in U.S.A., to full employment in Germany - Great Britain standing in between the two.

Section 5: Monetary Management from 1936 to 1939: Deliberate Adjustment of Demand for and Supply of Money at Full Employment Level.

In 1936 when rearmament investment was maintaining full employment in Germany, J.M.Keynes published his famous work "The General Theory of Employment, Interest and Money" in which he convincingly argued that public investment, by making potential demand effective, was capable of attaining and maintaining full employment, provided investment was sufficient in volume and adequate for the purpose. Before 1936, monetary policies were not directed to the attainment of full

employment. The object of the policies pursued was either recove ry or anti-cyclical, and their aim was at best to carry the economies back to the prosperity level of the twenties. The full employment attained in Germany was incidental to the rearmament policy. But Keynesian analysis claimed full employment to be the continuous objective of monetary policy. His theory at once captured the imagination of the scietific world and received the adherence of a wide circle of supporters. The full employment theory as further embellished by Keynes himself and his followers was epitomised in the theory of the full employment budget that was formulated in the closing years of the thirties and early forties.

The theory of the full employment budget advocated the undertaking of additional expenditure by the government over and above its ordinary financial expenditure, both of which were to be coordinated with private expenditure so as to create full employment.(1) For such a budget, the government had first of all to make an overall estimate of the total expenditure required to attain full employment. After ascertaining this total volume of expenditure, it was next necessary to estimate the private expenditure on investment and consumption that would be forthcoming at the level of full employment and the corresponding national income with the existing scale and structure of taxation. Lastly the essential and desirable state expenditure had to be estimated. Now, this state expenditure, together with private expenditure, must make up a total commensurate with full employment. If the

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(1) "Monetary Theory", by G.N. Halm, 1946. p. 449.

total exceeded the level commensurate with full employment, the excess acted as the inflationary gap which had to be corrected either by levying additional taxes on consumption or by reducing state expenditure. If the total, on the other hand fell short of that commensurate with full employment, the deficiency served as a deflationary gap, which had to be rectified by an increased government expenditure on investment having general social utilit With a full employment budget, not only would the cyclical patter of investment be eliminated but investment at the full employment level should also be attained.

There are certain limitations to the success of such a policy In the first place, certain factors of production may be in short supply. If, for example, all the items of the various factors of production were lying idle in huge quantities with the exception of machine repairers, a full employment policy would have its attempted expansion of production seriously obstru cted at the bottleneck of machine repairers. The machine needing repair might keep hundreds of workers and thousands of pounds worth of machinery absolutely idle. Attempts to employ all the workers on the remaining machines that were in running order woul yield sharply diminishing returns. Such attempts would raise cost of production very precipitously without increasing appreciably the volume of production. In extreme cases, it might be more profitable to keep a good number of workers on the dole rather

than in unproductive employment.

In the second place, changes in demand for some commodities, or changes in the technique of production in certain lines, are almost always occurring in this dynamic world. Because of such rises and falls in individual industries, it becomes necessary to transfer labour and capital from declining industries to ones which are thriving. But it is difficult for both labour and capital to effect the necessary transfer. The loss of training in one occupation, the time and expense needed to acquire new training for another, the break-up of established societies in declining areas, and the difficulty of housing them in new areas, cause great friction and suffering in the movement of labour from one industry to another. Transfer of capital is still more difficult as it means considerable loss on the values of capital goods and it might be less harmful to work half-capacity in the declining lines than to re-tool capital equipment for other lines. Due to these various reasons, there is likely always to be a certain percentage of unemployed men on shift from one industry to another. Monetary policy could not possibly eliminate this type of unemployment for which the more appropriate cures are organization of labour exchanges, labour training and housing accomodation in developing areas for facilitating transfer of labour, and compensation to the capitalists to secure the transfer of capital. When a monetary policy to secure full employment is obstructed at some obstinate bottlenecks or at the outskirts of structural maladjustments, further expenditure can not

increase production but is simply manifested in increasing prices

In the third place, a full employment policy always faces a potential danger of inflation due to the probable pressure from labourers for a general rise of wages. With full employment, the bargaining power is tilted in favour of the labourers, because th demand for labour tends to outstrip the available supply. Labourers, therefore, can fairly easily enforce a general increase in wage rates that is not offset by an equivalent increase in produc tion. This increase in wage rates increases costs, which in turn, raises the price of commodities in general. The wage-earners will suffer as consumers to an extent at least equal to the rise in their wage rates and this will impel them to demand a further increase in wage rates. A spiral of increased prices and wages will thus be started and would turn into a general inflation. Pre ssure for high wages, whether sectional or general, being the source of an inflationary spiral must be squarely faced and check ed from the start. This does not mean that there is no room for any increase in wages under a full employment policy. If as a result of better training or technical development, the producti vity of labour increases, then increased wages even to the fulles extent of increased productivity, will not raise costs of produc tion and prices. But any attempt to increase wages beyond produc ivity level will create inflation which will alter the distribu tion of wealth in favour of businessmen and the wealthier classe and to the detriment of wage-earners and other fixed income-earners. The propensity to consume of the upper classes being

lower than that of the poorer classes, inflation tends to diminis the effective demand of the society and ultimately to disorganize and frustrate the full employment policy itself. The maintenance of sufficient expenditure and the avoidance of inflation are, therefore, the two sine qua nons of a full employment policy.

Before the full employment theory was formulated in 1936, German (rearmament) full employment was already encountering almost all the difficulties enumerated above. Her rearmament production was obstructed by an acute scarcity of some essential raw materials, on the one hand, and trained labour, on the other. Her economy was, in addition, subjected to a strong inflationary pressure. Germany met the situation by controlling almost all the aspects of her economic life including wages and prices.

After 1936, recovery measures in certain countries became consciously full employment policies. Sweden provided a model example of compensatory government expenditure, without being marred by a rearmament programme, to maintain full employment. But it was rearmament investment (even before the world war began) that attained full employment in almost all the industrialised countries of the world.

Section 6: The Repercussions on International Trade caused by Increased Internal Economic Activity.

The increase in domestic economic activity attained by various countries by monetary measures had far-reaching repercussions on their international trade. The recovery expenditures of the different governments tended to energise the waning demand of the people by placing purchasing power in their hands. The

recipients of this new income did not restrict their purchases to domestic products; a part was spent on goods from outside. Hence, all these increased monetary expenditures of the governments , for whatever purpose they had been intended, had the inherent tendency to turn the balance of payments against the spending country. The deficit countries had to take measures to restore their balance of payments equilibrium, either to protect their gold reserves, or from the sheer necessity of providing the means of foreign payments. Exchange depreciation was the readiest method to attain this end. If a country, suffering from balance of payments disequilibrium, depreciated her currency to the extent likely to be brought about by market conditions, equilibrium could be restored without harming others or restricting international trade. But if depreciation was carried to a degree greater than that which competitive forces would have brought about, the balance of payments would turn in favour of the depreciating country and against other countries. In fact, many countries having recourse to this device carried the degree of depreciation beyond the equilibrium level. Competitive exchange depreciation of this type enabled a country to extend its foreign markets, increase its exports and thereby increase the scope of domestic production and employment. But this automatically meant the restriction of the market for other countries and, in consequence, a contraction of their volume of production and employment .

In order to protect their reserves and to restore their competitive position, other countries were compelled to take defensive measures, depreciating their own currencies, not only by wiping out the advantages of the first depreciating country, but by overdoing depreciation and creating competitive advantages for themselves. This engendered counter-retaliatory depreciation on the part of the first depreciating country. The currency history of the thirties recorded a complete devaluation cycle of this nature - a persistent rate-war. The attempt to seize each others' markets and to benefit at the cost of others impelled all to take measures against imports and thereby to restrict the volume of international trade itself. Moreover, it brought an element of risk into the domain of international exchange and this increasingly curtailed foreign trade all the more.

In the rate-war of the thirties and the rush for foreign markets, it was not economically feasible for all countries to have recourse to competitive exchange depreciation. Public opinion in Germany and France, for example, was against depreciation, because it wrongly identified depreciation with inflation. Moreover, depreciation was a costly process: it meant the exchange of more domestic goods for the same amount of foreign goods and, in the case of some countries, it proved to be a ruinous process. To prosecute her rearmament programme, Germany, for example, required large supplies of foreign raw materials which could be supplied by the countries of South-East Europe, which were suffering from a scarcity of markets for these goods because of keen competition from over-

seas producers. Despite her own urgent needs for these raw materials, Germany was in an advantageous position, being virtually the sole-purchaser. But, on the other hand, she was not in a position to supply manufacturing goods of the quality and quantity required by these countries. In these circumstances, if Germany had lowered her exchange rate, the price of her imports would have increased and that of exports would have fallen, but the sale of the latter would not have increased an iota. This would have made the means of her foreign payments to shrink all the more. It was, thus, to her interest not to lower the exchange-rate, if not to raise it, and to make purchases to the limit of her paying capacity. But as the paying capacity itself was meagre, it became necessary to restrict the imports to the most essential goods. For this reason, the German Government took over all the foreign exchange available from exporters and other possessors of foreign money and distributed it among importers or other persons who required foreign money. This exchange control by the Government was utilised not only for effecting a rationed adjustment of demand and supply of foreign exchange but also to divert foreign trade into the channels desired by the Government. Thus, exchange control not only reduced international trade, but it diverted it from its natural channels.

Under the impact of exchange depreciation and exchange control, international trade between countries became well-nigh impossible. The countries needing to carry on trade had to enter into various types of bilateral trade agree-

ments such as clearing and payments systems, reciprocal arrangements, bulk-purchase and even direct barter of commodities. These trade agreements themselves, however, opened a new vista of international trade, though of a more restricted type than multilateral world trade. By her ingenuous clearing and payments agreements, Germany carved out a currency area with countries in South-East Europe. Under the Cordell Hull system, U.S.A. developed a type of dollar area within which trade became slightly freer. The remaining gold standard countries of western and central Europe were automatically found to form a gold bloc, within which trade was less obstructed than between the bloc and the outside world. But the most significant currency bloc was the sterling area, which was brought into being almost spontaneously by the British Empire countries and some non-Empire countries depending on Great Britain as their main market, by stabilizing their currencies in terms of sterling after the breakdown of the gold standard in 1931. There was no exchange control within the sterling area, and within each of these monetary blocs, trade was comparatively more freely conducted than between these blocs.

In spite of the mitigating effects of the currency blocs, international trade was not only redirected and diminished in volume, but it was subjected to all kinds of vexatious controls. Despite a considerable increase in the internal economic activity of most of the advanced countries - in some cases exceeding the high-water-mark of 1929 - the international trade of these countries was well below the levels attained

by them in 1929. Moreover, it was obvious that the expansion of their production was mainly of an autarchic nature. The very necessity of all types of trade restricting devices proved the immense advantages that could be derived from a freer internati nal trade. If trade had been free, even a somewhat lesser volum of internal production would have given a net balance of advant ges to each of the countries concerned. In some cases, the autarchic ends of production were so palpably inefficient that the enthusiasm for conducting monetary management so as to stimulate domestic economic productivity began to wane, particularly during the closing years of the thirties.

Section 7: Simultaneous Attainment of Internal and External Objectives becomes the aim of Monetary Management in the 1940's.

The exigencies of the Second World War again compelled the belligerent countries to have recourse to the manufacture of money to an enormous extent. In some countries such as U.S.A. and, to some extent, England, the war demand put a considerable volume of unoccupied labour and capital to work and there was an immense increase in the net volume of production. In countries such as India, the net increase in production was relatively smaller than the diversion of production from consumption goods to war materials. Partly because of this diversion and partly because of the starving of consumption demand, there were inflationary tendencies in all the belligerent countries. In the advanced countries such as England, inflation was kept in check by price control and rationing,

while the same tasks were very inefficiently done in countries such as India and this made the incidence of the war burden unnecessarily heavy in the latter countries. But, whatever was the relative burden, the fact remains that paper money financed this colossal war effort and demonstrated once again its power to attain a set purpose. This led people naturally to infer that in peace-time also paper money should similarly be able to finance a correspondingly huge productive effort to increase the volume of consumption goods.

Much more prominently did the war conditions underline the immense advantages that international trade conferred on the peoples of the world and of which they were being deprived at that time. The advantages of the attenuated international trade that could be, and was, carried on during the war were too immense to be overlooked by anyone. War supplies from America saved Europe from utter destruction. At the same time war demand proved extremely beneficial to the American economy. During the thirties, U.S.A. was making strenuous efforts to acquire more and more foreign markets in support of her domestic production and, despite the adoption of various forms of "beggar my neighbour" policy, could not get rid of a huge unemployment problem. But during the war, demand for war materials not only provided full employment for American workers, but held out hopes that in the post-war years also reconstruction and development demand would maintain this full employment. In India and, to a certain extent, in all the belligerent and even neutral countries, people in general suffered extreme privation during the war

years from the blocking of international trade and the nonavailability of foreign consumption goods. Moreover, war production in India could not be expanded to the desired extent due to the nonavailability of capital equipment and trained labour from foreign countries which were involved in the war. The blocking of international trade , therefore, meant an immense economic loss to India. War experience thus abundantly demonstrated that the maintenence of a high level of international trade was as essential an economic objective as the stimulation of internal economic activity.

Theorists at the same time began to argue that the two monetary objectives that held the field at different times, that is, the maintenance of a high level of international trade up to the twenties and the stimulation of internal productivity thereafter, could be simultaneously pursued if the different countries of the world were willing to co-operate on monetary matters.(1) The attainment of the external monetary objectives involving the maintenance of the balance of payments equilibrium and stable exchange rates was always dependent on international co-operation. The international Gold standard system that constituted the means by which the external monetary objective was pursued, was itself a method o

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(1) "Preliminary Draft Outline of a Proposal for an International Stabilization Fund of the United and Associated "ations." Revised, July 10, 1943, Washington, D.C. (White Plan).
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"Proposals for an International Clearing Union." London, H.M. Stationary Office, Comd. 6437, April 7, 1943. (Keynes Plan).

international monetary co-operation. The existence of the gold standard depended on the observance of the gold standard rules by the countries participating in the system. This involved the regulation of the monetary supply of a country in accordance with its balance of payments situation and gold movements. The gold standard prevailed as long as international co-operation in the observance of these rules existed. When in the twenties international co-operation in these rules was lacking, the gold standard system broke down. Due to the absence of this co-operation, the gold standard could not be restored in the thirties. The different countries refused their co-operation in the observance of the gold standard rules (that is, in the maintenance of balance of payments equilibrium and stable exchange rates) because that involved fluctuations in internal economy. But if the balance of payments equilibrium (without involving fluctuations in the exchange rate) can be attained by methods other than fluctuations in the internal economy, monetary policy can pursue simultanelusly both internal and external objectives. A method of this kind is the making up of deficits in balance of payments of a country by arranging loans from the surplus country or countries, or from an International Monetary Fund organised for the purpose, so that the deficit country may meet its obligations without deflationary policies or without fluctuating its exchange rate. On the other hand, surplus countries, by lending out their surpluses, are not required to follow a reflationary policy. Thus the attainment of balance of payments equilibrium by this method will disturb neither the in-

ternal economy of any country nor its international trade.

The balance of payments difficulties postulated above are generally of a temporary or cyclical nature and the loans contracted by the deficit countries are almost automatically liquidated on the return of prosperity. There may, however, be disequilibrium of a more fundamental nature which may not tend to correct itself in the long run. If there are any fundamental causes such as different rates of development in the technique of production in a particular country and the rest of the world, or radical changes in their relative demand for each others' goods, the particular country concerned, or the rest of the world, will suffer from an unfavourable balance, which will go on accumulating and will ultimately paralyse international trade for want of the means of liquidating the balance. Such a disequilibrium can be corrected only by an appropriate adjustment in the exchange rate. An adjustment of exchange rate under these circumstances also may cause some disturbance in the existing foreign trade transactions, but the advantages of long run equilibrium will far outweigh such temporary dislocations.

But whether disequilibrium is temporary or fundamental and whether it should be corrected with advances from surplus countries (or an International Monetary Fund) or by adjustment in the exchange rate, it is to be emphasised that fixity in exchange rates and equilibrium in the balance of payments can be maintained only by international co-operation. Loans from surplus to deficit countries (or from the Monetary Fund) are ex hypothesi international affairs. Adjustment in

exchange rates also require understanding at least between the ~~two~~ countries concerned if they are not to lead to far-reaching evils, such as competitive devaluation. Granted this international co-operation, there is no reason why the monetary objectives of stimulating internal productive activity, on the one hand, and attaining a high level of international trade, on the other, should not be simultaneously aimed at by the monetary policy of a country. A country can apply monetary measures to secure the full employment of its available factors of production and, at the same time, it can use the factors so effectively that it secures the advantages of international division of labour by maximising international trade. It is, of course, true that if some countries adopt expansionary programmes while other do not, the former will increase employment and income faster than the others and will, therefore, develop an unfavourable balance of payments. This will go on accumulating and will ultimately upset the mechanism of international payments and thereby throttle international trade itself. If, on the other hand, all countries follow an expansionary policy based on the same fundamental principles, no balance of payments disequilibrium will develop, and all the countries will be in a position to pursue the objectives of maximum production and maximum international trade.

The attainment of a high level of international trade and of domestic economic activity is not, therefore, self-contradictory. On the contrary, the maximum development of international trade is possible only with full employment in all

the countries of the world. When the level of economic activity in the different economies of the world is lower than their respective productive capacities, the scope of international trade among them becomes correspondingly smaller and vice versa. In fact, it has almost inevitably been observed that a high level of international trade has always accompanied and followed a high level of domestic activities of the countries concerned. With a low level of internal productivity, on the other hand, international trade has been found to sink very low. Thus, if the productive activities of all countries are at their maximum, and if there is no obstacle or hindrance to trade among them, their international trade should also attain its maximum. The International Gold Standard system, which aimed at a high level of international trade, did not, and could not, consistently maintain a high level of trade simply because it did not concern itself with the employment policies of the member countries, but maintained a rigorous balance of payments equilibrium at all levels of employment. Hence, during the depressions, equilibrium in the balance used to be attained at very low levels of economic activity and at low levels of international trade. Balance of payments equilibrium tended to maximise international trade only at a given level of economic activity. To attain the highest potential level of international trade, what is needed is not only a balance of payments equilibrium but an equilibrium with full employment activities in all the countries of the world.

For maximum internal productive activity to yield the maximum international trade, it is absolutely essential that trade among the countries be unhampered by any restrictions. During the thirties, the expansion of the domestic economic activities of many countries, which was in some cases phenomenal, was not accompanied by a commensurate increase in international trade. This was due to the prevalence of protection, exchange control, competitive exchange depreciation, import control, the quota system and sundry other trade restricting devices. Within living memory, trade among countries was never absolutely free. It was always encumbered with all kinds of restrictions and it is similarly encumbered now. Hence, the combination of a maximum internal productivity with maximum international trade is only a theoretical speculation. A situation in which international trade is more or less obstructed by artificial barriers is nearer to the realities of the economic world.

Accordingly, let us suppose that both U.S.A. and Great Britain have attained full employment but imports into U.S.A. are subjected to high duties. As purchase from America is unrestricted, a part of the augmented income of the British people, in consequence of their full employment is almost sure to be spent on American goods, the purchase of which will fall short of Americans' purchase of British goods because of the American import duty. A deficit balance of Great Britain will ensue and this can never be equalised as long as Great Britain maintains full employment expenditure. Equilibrium will be attained only when expenditure and income in

Great Britain are reduced, diminishing thereby the British purchase from America to make them equal British sales to America. This will automatically involve partial unemployment and less than maximum economic activity in Great Britain. Due to the trade restricting policy of America, Great Britain will be able to attain neither a high level of domestic economic activity nor a high level of international trade. A similar situation will arise if, in place of protective duty, we assume America to be afflicted with a depression, or assume an excessive volume of expenditure in Great Britain.

If Great Britain imposes exchange control and restricts the volume of her purchases from America to the value of her exports to that country, her additional doses of full employment-expenditure cannot be spent to purchase American goods. With exchange control, Great Britain can maintain full employment, but this increased productivity will have no effect in further increasing her international trade. This increment of production will be of autarchic type and could be of greater value if trade with America was free. Though inefficient, this autarchic type of production is better than less production and is more desirable than the state of unemployment which will otherwise ensue. This type of full employment with exchange control is also subject to international approval and, in this case, American approval. Though not at all injurious to America, British exchange control may be misinterpreted as a device to restrict the American export trade and deserving of reprisals unless Americans are convinced that British trade with America can not increase, in any case

beyond the limit of her dollar exchange and the abolition of British exchange control will not increase her dollar earnings, but will only abrogate her autarchic part of production.

Thus granted international co-operation, the monetary policy can attain full employment with a high level of international trade if there is no undue trade barriers between countries. If and when there are serious restrictions to international trade, the monetary policy cannot attain the potentially maximum international trade but for the volume of trade that is possible over the barrier, the balance of payments equilibrium must be maintained to allow that trade to continue. As such an equilibrium is likely to leave some unemployment in the society, an autarchic full employment policy, under the protection of exchange control, should utilise the unemployed labour and other factors of production in the expansion of domestic production. This also involves a measure of international understanding.

Section 8: Major and Minor Economies.

The simultaneous maintenance of a high level of internal economic activity and international trade that has been accepted as the objective of monetary management in the present decade is thus found to be dependent on the global full employment activity on the one hand and free trade on the other. It is almost axiomatic that international trade as an objective of monetary management can materialise only to the extent that the countries of the world allow freedom of international exchange. As the matter now stands only an international understanding and agreement can liberate th

world trade from the innumerable restrictions that are throttling it so seriously. The global full employment activity on the other hand is dependent on a monetary expenditure that will utilise to the full the maximum productive capacity of all the countries of the world. If the overall expenditure is greater than what is required for global full employment, an inflationary pressure will be set afoot which will ultimately disorganize the full employment policy itself. On the other hand, if the overall expenditure is less than is required for global full employment, a depression will set in and will lower both the employment activity and the international trade of the world. The maintenance of the correct level of expenditure and effective demand at the level of maximum global productive activity is therefore the primary need of a sound monetary policy. But the maintenance of this adequate and correct volume of expenditure is an extremely difficult task and requires complete international understanding and co-operation.

If an individual country maintains a volume of expenditure greater than is required for full employment, it will not only turn the balance of payments against itself but will also spread a net inflationary effect to the rest of the world. If, on the other hand, its volume of expenditure falls short of its full employment level, it sends a net depressionary pressure to the outside world. If the country concerned is a very small economy of the world its inflationary or deflationary repercussions on the rest of the world will be so completely absorbed that its global

effect will

be negligible. Hence, mistakes by minor economies in maintaining the correct volume of expenditure on one side or the other, are not of any serious consequence. There are, however, a few big countries, each of which is bigger than scores of others and the volume of full employment expenditure of each of whom is a very significant part of the world expenditure. These big countries may be termed major economies as distinguished from all other smaller countries which may be styled minor economies. If any of the major economies maintains an expenditure considerably greater or smaller than its full employment expenditure, it will plunge the whole world into a vicious inflationary or deflationary spiral which will diminish both economic activity and international trade.

Great Britain was the only major economy of the world before World War I. She suffered from a great depression during the fourth quarter of the 19th century and stimulated a deflationary spiral all throughout the world during this whole period. She caused both world demand and international trade to sink to very low levels. During the first decade and a half of the present century, Great Britain enjoyed a prosperity boom and maintained an expanding volume of expenditure running ahead of her productive activity. She spread thereby an expansionary pressure to the rest of the world and stimulated world economic activity as well as international trade.

After World War I Great Britain ceased to be the only major economy of the world. She had to share this honour

first with U.S.A. and after 1924 with France and Germany as well From 1924 to 1929, all the major economies, with U.S.A. at their head, maintained an expanding expenditure and caused both productive activity and international trade to rise to very high levels. The crisis of 1929, brought the American expenditure and effective demand to a total collapse and this mutilated the volume of global demand to such a serious extent that the whole wor was subjected to a serious deflation and depression throughout the thirties. Both world economic activity and international trade sank to very low levels.

In the present decade and particularly after the Second Worl War, the volume of effective demand and expenditure maintained b the major economies has been far in excess of their respective productive capacity. Germany, one of the former major economies, is lying prostrate after the war and other major powers are maintaining for her a volume of expenditure which is by far greater than her present productive power. Both Great Britain and France have deficit balances and are spending more than they are producing. Even U.S.A. is maintaining a high level of domestic expenditure - at least, comparatively much higher than she maintained after the first World War. In the twenties her gold neutralizati and low price policy combined with her efforts to capture more and more foreign markets provided the much needed capital with which the productive organization of the war-shattered Europe wa rapidly rebuilt. Since the Second World War, due to a sharp rise of American prices in 1946, a much greater proportion of American production is being appropriated by herself and only a small par

of the deficit expenditure of the other major economies can now be met by her surplus exports. There is, therefore, a considerable balance of expenditure and effective demand in the major economies taken together over their present productive capacity. This excess expenditure is maintaining an inflationary pressure throughout the world. Inflation, by causing a shift of income from the poorer to the richer classes, and by undermining the basis of contract, is tending to disorganize the productive system of the world as well. Excessive monetary demand and consequent scramble for foreign goods is encumbering and throttling the foreign trade of the world more and more. In other words, the present excessive expenditure (and effective demand) of the major economies is an obstacle to the attainment of either the internal or the external objective of money.

During the thirties, when the volume of expenditure and effective demand fell short of the world's productive capacity, the various major economies followed their individual recovery programmes, involving the expansion of their respective effective demand, but due to their lack of co-operation and absence of co-ordination in their policies, much of their individual expansions had to be of autarchic type. Moreover, throughout the thirties overall global expenditure remained lower than the total productive capacity with consequent deflation and depression. The productive activity of the world, in spite of some increase in individual cases, continued to be low, while international trade was still lower. But in the twenties, when the volume of expenditure and effective demand ran ahead of the productive activity of the world, the

major economies, by subscribing to the gold standard, co-operated to keep the overall expenditure in check and saved the productive boom of the period from being disorganized by inflation. Both a high level of productive activity and international trade resulted from this co-ordinated monetary policy. After the Second World War, when the volume of expenditure and effective demand are running ahead of the world's productive capacity, as it did in the twenties after the First World War, only co-operation among the major economies can keep the increase in expenditure under control. The effect of a curtailed monetary expenditure by one major economy can be easily offset by the augmented expenditure of another. If all the major economies keep their respective expenditure and effective demand strictly commensurate with their full employment activity, both productive activity and international trade of the World can attain their maximum. The attainment of the monetary objectives is thus clearly dependent on the co-operation of the major economies in their monetary policies.

From the above it is obvious that the monetary policy of a minor economy, with reference to the attainment of monetary objectives, cannot be of any great significance. If the major economies maintain full employment expenditure, a minor economy, by simply maintaining stable exchange rates with them, can attain both a high level of international trade and internal productive activity. If, on the other hand, the policy of the major economies is either inflationary or deflationary, a minor economy cannot attain a high level of international trade by any means. If it maintains a stable exchange rate with the major economies, its internal

economy will fluctuate and both the internal economy and international trade will be half-depressed. On the other hand if it maintains stability of its internal economy by allowing the exchange rate to fluctuate, its international trade will suffer to a much greater extent. Its autarchic internal economic activity which can be maintained thereby, will be so inefficient (due to the extremely limited scope of the division of labour within its meagre economy) that it is very doubtful whether it will result in a net advantage over the situation which would arise if it kept a stable exchange relation with the major economies and thereby had its internal economy and international trade both half-depressed. A minor economy has, therefore, to choose between half-depressed international trade and domestic economic activity, on the one hand and autarchic (and, therefore, inefficient to a degree) full employment, on the other, by weighing the pros and cons of the alternatives. The attainment of a monetary objectives by a minor economy is thus dependent on whether (a) the major economies are maintaining their correct full employment expenditure and thereby attaining the monetary objectives themselves and (b) whether the minor economy concerned is maintaining a stable exchange relation with the major economies.

Section 9 : Monetary management in India.

India, in spite of her vast area and still vaster population is a country whose economic importance has been far smaller than that of any of the major economies of the world . It can , therefore, be considered as a secondary or minor economy of the

world and its appropriate currency policy can only be one of ada
tation to the international currency framework devised abroad. I
fact, currency policy in India for the last three-quarters of a
century has been nothing but conscious or unconscious, successful
or unsuccessful attempts at adaptation to the international curr-
ency policy and the main stages of the development of her currenc
management have been that of international monetary management.
The study of the currency policy of India, therefore, necessaril
involves a study of that of the international and as such of the
major economies of the time, because the latter automatically
determined the fundamental outlines and the main course of her
monetary management. The indigenous aspect of the Indian monetar
policy could only be the secondary function of adaptation to the
monetary policies of the major economies.

In the following five chapters of this thesis we have traced
both the international and the indigenous aspects of the develop
ment of the Indian currency management from 1873 to 1947. In
the following (second) chapter, Indian monetary management durin
the first forty-two years of this period, when the maintenance
of a higher level of international trade through stable
exchange rates was recognised to be the objective of monetary
policy, has been analysed. In the third chapter, the develop-
ment of Indian monetary management during the following
seventeen years, when the monetary objectives were
in conflict, has been reviewed. Chapter four discusses

Indian currency policy in the 1930's when the stimulation of internal economic activity was recognised to be the main objective of monetary management. The subject matter of the fifth and sixth chapters consists of the problems and policy of Indian currency management in the 1940's when a synthesis of both external and internal objectives, that is, a combination of the maximum levels of both international trade and domestic economic activity, is supposed to be the ideal. The fifth chapter contains an analysis of the international or external aspect of the Indian currency management, while the sixth chapter reviews the internal objective of a full employment policy in India. In the concluding (seventh) chapter, certain inferences have been drawn from past experiences and certain observations have been made regarding the future monetary policy of India with a view to a better attainment of both the external and internal objectives of monetary management.

The Problem of the Standards of Indian Currency

Chapter II.

Indian Currency Policy and Problems: From Fluctuating Exchanges to the Gold Standard. 1873-1914.

C H A P T E R II .

INDIAN CURRENCY POLICY AND PROBLEMS.

From Fluctuating Exchanges to the Gold Standard, 1873-1914.

Section 1: The International Monetary Situation prior to 1873.

Before the discovery of the Spanish-American mines in 1492 and, in a much more pronounced manner, after that discovery, both gold and silver coins were used concurrently in almost all the countries of the world.(1) From the close of the 15th century when Spanish-American gold began to pour into Europe, to 1873, the monetary system of the world may be said to have been one of bimetallism.(2) For the first three centuries (i.e. up to 1792) it was one of quasi-bimetallism or a parallel standard in which both gold and silver coins were freely minted and both circulated as unlimited legal tender money. During the last 81 years of this period (i.e. from 1792 to 1873) it was one of official bimetallism in which both silver and gold coins were minted at a legally determined ratio and both had an unlimited legal tender character. During these four centuries, the ratio of gold to silver varied but little, one weight of gold valuing from 15 to 15½ weights of silver.(3) During the quasi-bimetallic period, ex-

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(1) "Principles of Economics", by F.W.Taussig. 3rd Edition. Vol.I. Chapter: 'Bimetallism'.

(2) "Gold and the Gold Standard", by E.W.Kemmerer, New York, 1944, pp.26-39.

(3) Ibid.

change rates between countries were determined by the market rates between gold and silver in between 15 to 15½ weights of silver to one weight of gold. The striking stability of this market rate in comparison with the rates either before 1492 or after 1873, is explained by the compensatory action of bimetallism.(1) Whenever one of the metals became cheaper, it was coined in greater abundance than the other metal which became more abundant in the bullion market and consequently tended to be cheaper. This compensatory action, i.e. the tendency of the cheaper metal to crowd into the currency and to get scarce in the bullion market, made the ratio between the two metals extremely sticky.

During the time of official bimetallism, compensatory action was further stimulated by official support and gratuitous coinage. The official rate between gold and silver in European bimetallism occasionally differed from the American rate to a minor extent and it was found that each of the two continents tended to have a greater abundance of the overvalued metal and the market rate between the two metals stood in between the two official rates.(2) The weaker of the two areas at the time tended to lose the undervalued metal altogether and this made the market rate between gold and silver approximate the official rate of the stronger area.(3) Moreover, as long as one country kept bimetallism in operation, all the other countries of the world, having gold and silver

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(1) "The Purchasing Power of Money", by I.Fisher, 1911. Chapter 6.

(2) Ibid. Chapters 6 and 7.

(3) Ibid.

currencies, were knit together as if by a single currency system. The unified character of the system was not vitiated by the fact that the currencies of some countries, such as China, were reduced purely to silver while some other countries, such as England, adopted gold monometallism. Gold and silver became homogeneous metals for currency purposes at the ratio between gold and silver.(1) Even with one country on bimetallism, all other countries enjoyed the beneficial effects of the system without being subjected to the stress and strain of its compensatory action.(2)

The bimetallic system of currency manifested itself both in the national and international sphere of economic activities of the different countries of the world. Gold and silver, considered as a homogeneous mass at the existing ratio between the two metals, became the standard of value in every country whether it had gold and silver monometallism or had concurrent gold and silver currencies. In the sphere of international exchange, the exchange rates among different countries were determined by the ratio of physical quantities of money-metals in their respective currencies at the prevailing ratio of gold and silver in the system. Balance of payments disequilibrium between countries was corrected almost automatically by physical shipment of money-metals from one country to another. With stable rates of exchange and balance of payments equilibrium, international trade had the

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(1) "Principles of Economics", by F.W.Taussig. 3rd Edition. Vol.I. Chapter: 'Bimetallism'.

(2) "The Purchasing Power of Money", by I.Fisher, 1911. Chapters 6 and 7.

fullest scope for development at the given levels of production and income in different countries.

The contribution of the bimetallic monetary system (during this long period of about four centuries before 1873) to the economic development of the world was much greater than its service as the standard of value in the various economies of the world, on the one hand, and maintainer of balance of payments equilibrium, on the other. Before gold and silver began to pour into Europe (from Spanish-American mines from 1492 onwards) economic transactions both in international and domestic sectors were mainly carried on by direct barter of goods. Subsequently the continuous imports of bullion replaced barter by monetary exchange at an ever-increasing rate in Europe and Asia and magnified the volume of exchange by eliminating the inconveniences of barter. The effect of this increased supply of money metals was at first more pronounced in the domain of international trade. The replacement of international barter by monetary exchange brought about a veritable commercial revolution and hastened the termination of the self-sufficient economies of the middle ages. The expanded world market, in turn, stimulated productive activity in almost every country of the world.

The replacement of barter by the use of money in the domestic sector of different countries facilitated their exchange and increased the volume of their internal trade. The development of foreign markets in addition, made the volume of trade of each country much bigger. But there was still another source of the expansion of domestic production of all countries. The ever increasing

ing supply of money metals from America ran much ahead of the productive activities of the countries of Europe at the prevailing prices and there was a sustained profitability of productive undertakings for centuries. This could not but provide a great and continuous stimulus to production in Europe during this period, which ultimately brought about the Industrial Revolution in Great Britain.

The part played by money-metals in bringing about a commercial and productive revolution of the world received an exaggerated homage from the economists of the 18th century who were known as the mercantilists. The best exposition of their theory was given by Sir Thomas Munn- a director of the East India Company. The central idea of the mercantilist theory was that the real wealth of a country consisted of precious metals(gold and silver) only and that the favourable balance of trade was the means to increase the supply of such metals and to enrich a people. The mercantilist theory received much hard criticism at the hands of the utilitarian economists of the 19th century who saw to its complete rejection by the academic world.(1) Nevertheless, there was an element of truth in the theory. Though the constantly increasing supply of precious metals ran much ahead of productive activity yet the latter was considerably below the maximum potential capacity and every increase of money-metals, by facilitating exchange, led to an increased productivity several times greater than the increment of precious metals. It

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(1) "History of Economic Thought", by Haney.
Chapter: 'Mercantilists'.

is no wonder that in these circumstances money-metals were considered to be the only real wealth. Actually they were more than that- they were the creator of wealth. Although many other causes contributed to bring about the Industrial Revolution - the ever increasing supply of precious metal was undoubtedly its most potent cause.

The economic historians consider 1830 to be the concluding year of the first phase of the Industrial Revolution and the beginning of another, Commercial, Revolution. The gigantic volume of production brought about by the mechanised system of the Industrial Revolution not only required mechanised transport for its exchange and distribution, but also a correspondingly huge amount of precious metals to serve as the medium of exchange. The increasing production nearly caught up with the increasing money-metals and was about to wipe out the monetary stimulus to production in the 1840's when the Californian gold mines were discovered in 1848 and Australian gold mines in 1849 (1). Great Britain had introduced gold monometallism since 1821 and the gold coming from the newly discovered mines swelled primarily her money-supplies. But due to the prevalence of bimetallism in most of the other countries of the world the effect of this increased gold was dispersed on the entire volume of money of the world. Nevertheless, with gold currency, Great Britain had an initial advantage in this expanded money supply on account of the new gold production from the mines. From 1850, the world's money-supply again ran much ahead of production. Profitability of production was thereby more than

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(1) "Gold and the Gold Standard, by E.W.Kemmerer, New York and London, 1944. p. 80.

maintained and productive activity continued to increase. The exchange of the vast volume of Great Britain's industrial produce with the rest of the world, knit up the whole world into one market with Great Britain as its central forge. The period from 1850 to 1873 is known as the golden period of Great Britain's economic history,(1) and the increase of gold did play not an insignificant part in this attainment.

Section 2: Monetary Management in India prior to 1873.

India received a good share of precious metals coming from the Spanish-American mines almost from the beginning of the 16th century through her spice trade. Vasco-da-Gama discovered the Cape route to India in 1498, shortly after the discovery of the Spanish-American mines and the merchant ships of all the other commercial countries of Europe followed along this route to India in quick succession. Spices and other rarities of India enabled her to earn large quantities of gold and silver, imports of which continued to increase with the lapse of years. Increased supplies of precious metals enabled India to replace barter exchange by money to such an extent that we find Todar Mall - the finance minister of Akbar the Great - fixing land revenues in terms of money,(2) instead of by proportions of produce. The introduction of a monetary economy, by facilitating exchange, must have expanded Indian production. Constant increase of precious metals must also have increased the monetary profitability

(1) "Industrial and Commercial Revolutions in Great Britain in the 19th century", by L.C.A.Knowles. p.144.

(2) "Cambridge History of India". Vol.IV. Cambridge University, 1937. p.463.

of various industries - particularly those connected with foreign trade.

India, moreover, had a double standard from the beginning of the 16th century. Akbar introduced the Gold Mohur and Silver Rupee, each having the same weight of 175 grains troy and both circulating concurrently.(1) Both the coins were common measure of value, though they circulated without any fixed ratio between them. Market conditions, however, could not but establish a relation between them and the Indian ratio must have kept parity with the world ratio and thereby India seems to have maintained stable exchange rates with the other countries of the world. This stable currency relation with the other countries must have stimulated Indian foreign trade to a very great extent.

When the Moghul Empire broke down and, on its ruins, arose a large number of independent principalities, the currency situation became anomalous. The Moghuls considered the right of coinage as the most unmistakable sign of sovereignty and for this very reason, political adventurers also issued coins as the first step in declaring their independence. These new sovereignty-hunting princes wanted to have each a separate coin of his own. With innumerable new princes in the different parts of the country various coins of gold and silver with different weights and fineness came into circulation. The country was flooded with myriads of coins which not only bore the names of new kings but also were different from the Moghul coins in weight and fineness. In most cases,

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(1) "The Problem of the Rupee", by B.R.Ambedkar, London, 1923. p.3.

these were wantonly debased without always altering the denominations.[1] A definite class of indigenous bankers grew up who specialized in the evaluation of the real worth of different coins[2] and they were known as shroffs. Once these bankers ascertained the value of a coin, it circulated freely together with others. Thus the break up of the political organization simply increased the multiplicity of both gold and silver coins, all of which circulated at their metallic value at the existing ratio between gold and silver. Bimetallism thus proved itself independent of diversity of coins as well as of political organizations.

When the East India Company became the rulers of the country, they found as many as 994 different coins made of gold and silver and of varying weight and fineness in circulation.[3] Within their territory, the Company suppressed all other coins but their own. Next, they tried to establish a legal ratio between their gold coins and silver coins. But in all the three Presidencies, into which the Company's occupied territories were divided for the purposes of administration, this attempt to establish a legal ratio was more or less a failure.[4] The underlying reason for these failures lay in the fact that the Indian ratio differed not only from the then bimetallic ratio in Europe, but each of the three Presidencies had its own different rate. Their failures simply demonstr-

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(1) "Indian Currency" by H.M. Macleod, p.13. Quoted by Jather and Beri in their 'Indian Economics', Vol.II, Bombay, 1945. p.251.

(2) "The Problem of the Rupee" by B.R. Ambedkar, London, 1923, p.6, footnote 1.

(3) "Indian Currency" by H.M. Macleod, p.13 Quoted by Jather and Beri in their 'Indian Economics', Vol.II, Bombay, 1945, p.251.

(4) "The Problem of the Rupee" by B.R. Ambedkar, London, 1923, p.34.

ated that it is not possible to maintain two or more different ratios in a bimetallic system of currency. The ratio of the economically less important area was bound to be nullified. The best course for India would have been the Moghul method of free coinage of gold and silver leaving the ratio between them to be determined by the European bimetallic system which dominated the Indian system all the same - despite Indian attempts to the contrary.

The most determined effort by the Indian Government to break away from the bimetallic system and to establish an independent silver monometallism was made in 1835 by passing the Silver Act which demonetized gold and introduced a common silver rupee for the country as a whole. This involved a sudden withdrawal of about one half of the Indian currency and was most inopportune under the circumstances of that time. (1) The first phase of the Industrial Revolution in Great Britain reached a stage of completion by 1830 before which her trade with India was restricted to spices, indigo, superfine cotton and silk goods and other rarities having great value in small bulk. But when, after the mechanisation of the British productive system, commodities of common use such as clothing, utensils etc. were produced and exported to India, after 1830, en masse, the economic life of common men in India began to be affected. Indian society was based on self-sufficient village communities consisting of agriculturists and artisans, the bulk of whose needs were mutually supplied by

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(1) "The Problem of the Rupee", by B.R.Ambedkar, London, 1923. p.22.

themselves. But when cheap machine products began to reach first the coastal and riverside villages, and after the opening up of railways, the villages near the railways, village artisans lost their trade and became landless agricultural labourers.(1) Agriculturists sold their surplus agricultural products to foreign merchants to enable them to buy foreign goods, and India became an importer of manufactured goods and exporter of agricultural products and raw materials(2). This commercialization of Indian agriculture being on the lines of the geographical division of labour was bound to increase the wealth of India but this required at the same time a correspondingly big volume of money-metals to effect exchanges. But at the early stages of this commercial revolution, the Indian government, by demonetizing gold and reducing the money supply, created a great stringency in the money market.

The monetary stringency brought about a depression and the Government was forced to issue a proclamation in 1841 permitting the acceptance of gold, in payment of government taxes, by the public treasuries at a ratio of 15:1, the market rate at that time. This gave a great fillip to the reintroduction of gold money and the currency system became bimetallic again. After the discovery of the Californian and Australian gold mines, gold became more plentiful than silver in the fifties, at the official rate of one weight of gold to fifteen weights of

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(1) "The Economic Development of India", by V. Anstey, London, 1946. pp, 330-331.
(2) Ibid. p. 331.

silver. The members of the public now began to pay their taxes only in gold coins. This meant a loss to the Government because it could not force these coins on its creditors at the official rate due to their non-legal tender character. In 1852, therefore, the Government suspended the acceptance of gold coins in payment of public dues altogether. This made the monetary situation once again stringent and the people began to use raw gold for monetary purposes side by side with the silver rupees, at the market ratio.(1) This fact was brought to the notice of the Government by the Bombay Chamber of Commerce in 1863 and the Government accepted the inevitable again. By a notification in 1864, it authorised the public treasuries to accept, in payment of public dues, sovereigns and half-sovereigns at a rate of ten rupees per pound. Treasuries were also authorised to make their payments in sovereigns and half-sovereigns whenever they had a supply of those coins and provided people were willing to accept them in payment. In 1866, the Government appointed the Mansfield Commission to report on the desirability of the reintroduction of gold coins. The Commission gave its verdict in its favour. The Government issued a notification in 1868 and made the sovereign legal tender in India and at the same time raised the rupee-value of sovereigns and half-sovereigns from Rs.10 and Rs.5 to Rs.10-8-0 and Rs.5-4-0, to bring the ratio between rupees and sovereigns into conformity

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(1) "The Problem of the Rupee", by B.R.Ambedkar, London, 1923. p.42.

with the market ratio. But as the gold-value of silver fell further, sovereigns tended to disappear from circulation and the government passed an Act in 1870 which made the rupee the only legal tender in India. This, however, brought the sovereign back into circulation at its metallic value. This was the situation up to 1873.(1)

Thus we find that India had the continuous record of a bimetallic currency system from the 16th century to 1873. This system waded through the breakdown of the Moghul Empire and the unsuccessful ratio experiments of the East India Company. The persistence of gold coins and bullion in circulation despite the Silver Act of 1835 not only maintained the bimetallic character of the system but also provided the absolutely essential media of exchange which made possible the commercial revolution in the Indian economy.

SECTION 3. The International Monetary Situation after 1873. The Great Depression.

The Franco-Prussian War of 1870, from which Prussia came out victorious, was followed by the emergence of the German Empire, with the Prussian king as the Emperor of Germany. The newly formed Empire probably thought it unbecoming to have any other metal than gold in her currency. In 1873 she not only demonetized silver, but also melted down a huge quantity of silver coins and sold them for bullion. The movement for demonetizing silver once set on foot was immediately followed

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(1) "The Problem of the Rupee" by B.R. Ambedkar, London, 1923. pp.45-48.

by other North-European countries bordering on Germany. America also closed her mints to the free coinage of silver immediately after Germany. The countries of the Latin Union did the same in 1877. Bimetallism was universally suppressed but it left behind a gold standard in some countries, and a peculiar, limping standard in others, such as U.S.A. and France. In these limping-standard countries, silver coins, already minted, were allowed to remain in circulation at their face value side by side with gold coins, but no new silver coins were added to the circulation.(1) Due to the fall in the price of raw silver which followed, there arose a difference between the price of silver coins and silver, the face value of the coins becoming higher than their bullion value. Whatever was the value of gold coins, was also the value of silver coins. Owing to the retention of free coinage of gold, the value of gold coins and gold bullion was the same - and the value of silver coins, so to say, limped behind the value of gold. The Limping Standard was, in effect, a gold standard - overvalued silver coins simply economising the use of gold.

Silver displaced from bimetallic currencies accumulated in the bullion market and became cheaper in relation to gold at the official bimetallic ratio (1:15.5). It then began to swarm in the currencies of Asiatic countries, such as India, China, Indo-China and the Pacific Islands where it was still freely minted, and drove gold out of circulation by the operation of Gresham's Law. These countries were completely de-

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(1) "The Purchasing Power of Money", by I.Fisher, 1911. Chapters 6 and 7.

nuded of their gold coins and were reduced to silver monometallism. The international currency system was thus bifurcated into two disjointed monetary blocs of gold and silver.[1] If the ratio of the total volumes of trade between countries reduced to silver monometallism, on the one hand, and the countries on gold monometallism, on the other, had been the same as the ratio between the total value of silver and the total value of gold at the then ration (1:15.5) there would not have been any change in the gold value of silver. But as a matter of fact, the percentage of world trade carried on by India, China and other Far-Eastern countries, on silver, was by far smaller than the percentage of the total value of monetary metal possessed by silver at that ratio. This necessitated an internal revaluation of gold in the gold bloc and silver in the silver bloc. As the supply of gold suddenly fell short of what the price-structures of the gold standard countries required at the existing level, it led to a lowering of prices in the gold standard countries. For contrary reasons, the price levels in the silver standard countries began to rise.[2] Very serious consequences followed from this disruption of the relation between gold and silver.

The downward tendency of prices in the gold standard countries reduced the profitability of their productive enter-

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(1) "The Purchasing Power of Money", by I.Fisher, 1911. Chapters 6 and 7.

(2) "Gold and the Gold Standard", by E.W.Kemmerer, New York, 1944. p.89.

prises. The entrepreneurs were, therefore, compelled to reduce wage rates as well as to reduce their scale of production and this made millions of people unemployed. Unemployment and the reduced wages of the employed diminished national income which, in turn, reduced demand for consumption goods. This reduced the profitability of productive enterprises all the more. A vicious circle of deflation, unemployment and diminishing income was set on foot. The deflation was particularly acute in industrial enterprises and Great Britain, as the industrial forge of the world, was particularly hard hit and suffered the worst depression of the 19th century. The downward trend of commodity prices, employment, wages and income in Great Britain was paralleled by similar trends in other gold standard countries including U.S.A., Germany and France. But the diminution of income and purchasing power of Great Britain had a particular significance due to the fact that she was by far the biggest import market of the world. Other gold standard countries depended on Great Britain for the sale of the bulk of their products. With the shrinkage of the British market, these countries were encumbered with undisposed products that went on accumulating. Hence, the other gold standard countries suffered two-fold difficulties - firstly due to the fall in the gold prices of their goods and secondly, and this was much more serious, due to the shrinkage of the British market.

It is generally supposed that the Great Depression in Great Britain in the last quarter of the 19th century was caused by serious German and American competition supported

by high tariff walls in both these countries. The severity of competition of German industry was certainly exaggerated. Germany began late in the industrial race and her growth, which was greater than that of Great Britain, was only to be expected. But the range of competition of German industry with British industry was quite restricted. With the exception of iron and steel, they hardly clashed with each other and even here Great Britain more than held her own, her exports increasing from £28.3 million in 1870 to £37.6 million in 1900. Hence, German expansion can hardly be said to have been achieved at the cost of Great Britain.(1) So far as the responsibility of the tariff in creating the depression is concerned, there is no doubt that Germany adopted a protectionist policy after 1880 and so did U.S.A. after the victory of the Northern States in the American Civil War. But the German tariff of 1880 reduced the volume of British exports to Germany only from £10 million to £7.7 million at which level it remained up to 1890 when it began to rise again. Exports to Holland, Belgium and France remained stationary during the period while exports to U.S.A. showed a constant increase up to 1894. But the period of really high protection began with the Mackinley Tariff of 1891 in the U.S.A., succeeded in the following year by increased tariffs by France, Spain and Portugal. Thus, protection became a serious obstacle to trade at the closing stages of the Great Depression, which occurred in

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(1) "Industrialization and Foreign Trade", League of Nations, 1945. p.78.

the middle nineties.[1] The diminishing market was naturally scrambled for by the countries encumbered with excess production and the tariff walls raised by Germany, U.S.A. and France were attempts to conserve as much of that attenuated market as possible by each country. Tariffs were thus not a cause of depression, but its effect.

The seriously diminished purchasing power of the customers of Great Britain and other gold standard countries, which comprised virtually the whole of the international market (with the minor exception of the silver area) now clashed with their increased, and, probably even then, increasing productive power. While before 1873, the world market could be termed a sellers' market, because the monetary purchasing power of the people increased at a faster rate than production, and therefore sellers could dictate their terms, after 1873 the world market became a buyers' market because production was in excess of effective demand, and buyers, due to their paucity, could dictate their terms. To put it in another form, the volume of effective demand[2] fell below the level of the productive capacity of that period. Thus diminution of the purchasing power of the people in general, in the gold standard countries, reflected itself in a diminished purchase of foreign goods, and therefore, in a shrinkage of foreign trade.

The trade of the gold standard countries with the silver area was also seriously dislocated by the constantly falling silver exchange. The suspension of silver from currency

(1) "The Industrial and Commercial Revolutions in Great Britain in the 19th Century", by L.C.A. Knowles, pp. 144-147.

(2) Vide infra p. 4.

synchronised with a high output of silver from newly discovered mines and the introduction of improved processes in all the mines. But the increased supply of raw silver in the last quarter of the 19th century was not disproportionately greater than the increase of gold in the third quarter of that century.(1) And yet their relative value during the first period was wellnigh constant at the ratio of 1:15½ while in the third quarter, the value of gold fluctuated between 16.10 and 26.75 weights of silver per one weight of gold.(2) The cause of this difference lay in the operation of the compensatory action of bimetallism in the earlier period and its suspension in the later period. The increased supply of silver simply made the already bad situation worse and brought about a catastrophic fall in its price which stood at the close of the century at a level about 75% lower than the 1873 level.(3) It meant a continuous appreciation of the exchange rate of the gold standard countries in relation to the silver area. This restricted the trade of the former countries in various ways.

The export trade of Great Britain and all the other gold standard countries began to suffer a competitive disadvantage in comparison with the producers of similar goods in the sil-

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(1) "Gold and the Gold Standard", by E.W.Kemmerer, New York, 1944. p.90.

"Report of the Herschell Committee, 1893." para.6.

(2) Ibid.

(3) Ibid.

ver area.[1] The Indian cotton industry, for example, was said to be at a considerable competitive advantage over the Lancashire industry during the prevalence of the silver standard in India.[2] Though it may be argued that the Indian cotton industry did not produce the same kind of goods as Lancashire exports, yet it cannot be denied that due to the wide scope of substitutability of one kind by the other, Lancashire exports suffered grievously in the Indian market. Secondly, due to the continuous fall in the silver exchange, the prices of imports from gold standard to silver standard countries were constantly rising and, in consequence, there was an overall shrinkage in the amount of imports from gold standard countries demanded by customers of the silver area. Last, but not least, constantly changing exchange rates brought about an element of risk in foreign trade with the silver area generally and tended to restrict the volume of international trade.

Taking an overall picture of British trade with the rest of the world, while during the previous period, it expanded continuously, during this period, not only was that expansion suspended but there were actual recessions at times, that is from 1872 to 1879 and from 1883 to 1887. These trade recessions and trade stagnation simply reflected the decline and slowing down of British internal economic activity. While the index of manufacturing production (taking 1913 - 100) in 1872

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(1) "Report of the Herschell Committee, 1893". para.27.

(2) "Indian Fiscal Commission Report, 1921-1922". para.154.

was 48, it sank down to 45.6 in 1879 and from 59.9 in 1883, it fell to 57.5 in 1887.(1)

Thus, the observance of the gold standard rules brought about the Great Depression in Great Britain and as this led to the collapse of the British import market, the British depression was magnified into world depression. Although Great Britain was maintaining gold monometallism from 1821, yet she was enjoying the protection of bimetallism up to 1873 after which she, and through her, the world, had to pay the price of the gold standard in the form of persistent depression for about a quarter of a century. The gold standard, of course, enabled Great Britain to maintain her balance of payments equilibrium and stable exchange rates within the gold area and thereby to maximise her international trade but this maximum trade represented a comparatively low (depression) level of economic activity. In fact, the international gold standard began its career by depressing internal economic activity and stagnating international trade.

Section 4: Monetary Management in India from 1873 to 1893.

After the breakdown of bimetallism in 1873, silver, on a large scale, began to flow into the silver standard countries, and India, particularly became a sink for silver which was largely coined into rupees. India was having an increasing supply of money and a rising tendency of prices even before 1873 due to the increased supply of gold from Californian and

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(1) "Industrialization and Foreign Trade", League of Nations, 1945. p.132.

Australian mines and its absorption in the international bimetallic currency of which Indian currency formed a part. But the increase in money supply after 1873, due to the excessive concentration of silver in India, was immensely greater than that before 1873.(1) This heavy coinage of silver set up a decided tendency towards a much greater rise of prices in India than before 1873. The rising tendency of prices made Indian investments and productive enterprises still more profitable. The Monetary situation in India and other silver standard countries was, therefore, exactly the reverse of that in the gold standard countries as in the former effective demand was running much ahead of production and exerting a strong pressure towards an increase of employment, income and production.

The rise of internal prices benefitted the Indian industrialists to a very great extent. The Industrial wages and other elements of cost of production did not keep pace with the rise of prices and, therefore, the cost of production of the industrialists did not rise as much as the sale proceeds of their products. Due to their ever-increasing profits, industrialists were constantly increasing their scale of production during this period. For example, the cotton industry of India more than trebled its size during these twenty years while the jute industry was nearly doubled.(2) Agricultural production, however, could not be increased under

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(1) "The Economic Development of India", by V.Anstey, London, 1946. p.410.

(2) "India's Foreign Trade since 1870", by Dr.P.Roy, London, 1934. pp.151-165.

the stimulus of high prices. Agricultural production was determined more by natural factors than economic stimulus and it maintained nearly a constant volume irrespective of price fluctuations.

The external effects of the silver standard in India were more striking than its internal effects. With the constant fall in the gold price of silver, the exchange rate continuously fell lower and lower. From 58 pence per ounce in 1875, the price of silver fell to 52½ pence in 1879, 43 pence in 1888 to 37½ pence in 1892. With the fall in its silver value, the exchange value of the rupee in terms of the sovereign began to move down and fell from about 2s.0d. in 1871 to about 14 pence in 1892.(1) Not only did the exchange rate suffer a steady fall during this period, but it had a seesaw movement as well. The widest variations of the previous decade occurred in 1865-66 and 1866-67 during the American Civil War when the range of fluctuations was only 7.6% in the first year and 8.8% in the second year. But the ups and downs in the silver period was much wider and their range went as far as 19.25%.(2) The fluctuating exchanges introduced an element of risk into the trade of India with the gold standard countries and added to the cost of such trade. But this disadvantage was more than obviated by the exchange advantage which the constantly falling rupee exchange conferred on Indian exports. The In-

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(1) "Report of the Herschell Committee, 1893". paras.3,4 and 5.

(2) "India's Foreign Trade since 1870", by Dr.P.Roy, London, 1934. p.148.

dian exports to gold standard countries progressed much faster than exports to silver standard countries having stable exchange rates with India, proving thereby the export stimulating effect of falling exchanges. This special increase of India's trade with the gold standard countries was particularly important because the bulk of her trade was with the gold area. Indian trade with other silver standard countries constituted only 26% of the total foreign trade while the trade with the gold standard countries constituted the remaining 74%.(1)

But the expansion of Indian foreign trade was seriously hampered by two obstacles. Firstly, imports of India consisted mainly of manufacturing goods while her exports consisted of agricultural products and raw materials. Constantly falling Indian exchanges, by making foreign imports of industrial goods costlier to the Indian consumers, gave virtual protection to the Indian industries. The expansion of Indian industries during the silver period, as we have noted above, can at least partly be traced to this exchange depreciation. On the other hand, falling rupee exchange made the prices of Indian exports constantly cheaper to the foreign buyers who would naturally be willing to buy more Indian goods. In comparison with a competitor from the gold standard area, the Indian exporter was at a definite advantage to increase his exports. But Indian exports consisting mainly of agricultural products, supplies of which were inelastic, were not in a position to benefit from this competitive advantage.

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(1) "Report of the Herschell Committee, 1893". para. 24,-27

In the second place, due to the prevalence of the Great Depression in the gold standard countries, which constituted three-fourths of the market for Indian exports, there was a substantial shrinkage of foreign demand for Indian goods. Nothing short of the restoration of the purchasing power or return of prosperity of the gold standard countries could have led to any substantial increase of purchases from India. Under these circumstances, the falling rupee exchange simply lowered the price of Indian goods to foreigners and made the foreign exchange earnings of India constantly diminish. Indian foreign trade had not apparently attained any real increase during this period. From an annual average of Rs.99.14 crores during the quinquennium ending in 1873-74, the aggregate value of the total trade of India rose up to Rs.197.36 crores in the quinquennium ending in 1893-94. In other words, in the course of twenty years the value of aggregate trade nearly doubled. But the value of silver having been halved it may be seriously doubted whether the increase of Indian foreign trade in terms of rupees represents any increase at all.(1)

The only definite thing that the depreciation of the silver exchange did was the constant deterioration of the terms of Indian trade. As the prices of foreign imports (and, therefore, of all manufacturing goods) were on a constant increase and the prices of agricultural exports were constantly falling, the Indian farmer found his income and purchasing power decreasing. In view of this fact, it is not at all to be wondered at that this

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(1) "Report of the Herschell Committee, 1893". paras. 6-16 and 24-27.

period was blackened by some of the worst famines in the records of India, during 1877-78 and 1878-79. Strangely enough the famine year of 1877-78 recorded a phenomenal increase of trade and surpassed all previous records including that of the inflated trade of 1865-66.(1) In the second year of the famine, however, trade was considerably restricted, but even then recorded an increase of 12.58% and was well above the level of any other year than 1865-66; the year of the American cotton famine.(2) The causes of these severe Indian famines may probably be traced to crop failures in the preceding years, but it cannot be denied that the record increase of exports, mainly agricultural goods including food crops, during the famine years had something to do with aggravating the intensity of famines particularly as there was a relatively less increase in the income of consumers and wage earners in comparison with the rise of prices.

The falling exchanges and rising prices created serious difficulties in long term capital investments in India. As the value of rupee securities was constantly falling in terms of gold, which was the standard of Great Britain, the premier lending country of the world, the entry of foreign capital into India considerably slowed down. The uncertainty as regards the sterling value of the interest on the investment and the prospect of the diminution which the investment capital might suffer, if it were desired to retransfer it to England,

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(1) "India's Foreign Trade since 1870", by Dr.P.Roy, London, pp.51-56.
(2) Ibid.

discouraged the British investors all the more. Foreign firms were also finding a difficulty, owing to the falling exchange, in procuring the services of European servants required for conducting their undertakings in India. Moreover, the Indian Government adopted a policy of developing what was called extra-ordinary public works, i.e. a system of transport, mainly railways and a net-work of irrigation, financed by capital borrowed from England. The government was very much handicapped in borrowing money from England because every sterling loan became a constantly increasing burden in terms of rupees and the government dared not shoulder such a huge burden.(1) Hence, the development of these extra-ordinary public works was seriously handicapped and the economic progress of the country retarded.

The fall of exchange created a further and extremely serious difficulty for the Indian Government because of its obligation to make big sterling payments to England. Being based on silver, India had to offer an increasing price for procuring sterling or gold. Prior to 1873, this difficulty was absent because the ratio between the rupee and sterling was stable. But after 1873, the same amount of silver currency could only purchase less and less amounts of the currencies of the gold standard countries, such as Great Britain. With an obligation to pay Home Charges in terms of sterling, the Indian Government was required to levy higher and higher taxes to make up the deficit in the sterling value of the

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(1) "Report of the Herschell Committee, 1893". para.28.

rupee. The budget estimates of the Government were repeatedly upset by the fall of the silver value.(1) What was calculated by the Finance Member today was upset by the change in the price of silver tomorrow. The total excess of rupees needed to provide for the net annual sterling payments over these required to meet the sterling obligations increased from about Rs. 87 lakhs in 1875-76 to over Rs. 10 crores in 1891-92.(2)

During these twenty years of the silver standard, Indian agriculturists were suffering from the greater rise of prices of foreign goods they bought in comparison with prices of things they sold, long term investments were being seriously retarded and Indian finance became chaotic.(3) In comparison with these disadvantages, the developing industries formed an insignificant benefit to the Indian economy. The origin of all these difficulties could be traced to the depreciating silver currency which proved by implication that a stable exchange relation with Great Britain was immensely more important to India than to have a bigger volume of money-supply and rising prices. The more potent cause, than the depreciating silver currency, that caused the Indian difficulties was, however, the Great Depression in the gold standard countries which diminished the demand for Indian exports.But the Great Depression itself was of monetary origin.

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(1) "Report of the Herschell Committee, 1893". para.3.

(2) Ibid. para 3-5.

(3) " The Economic development of India", by V.Anstey, London 1946. pp 393 and 410.

The blind mechanism of the gold standard, according to which monetary management was carried on in the gold area, restricted the supply of money and brought about that situation. While the overabundance of money was the cause of trouble in the silver area, the scarcity of money was the centre of trouble in the gold area. The removal of overabundance in the former and scarcity in the latter, that is, the adjustment of the volume of money to the productive capacity in both the areas, was the way to restore currency equilibrium and maintain the economic progress of India.

In spite of all attempts to increase revenues and decrease expenditures, the government budget was always in deficit during the whole of this period. Mainly due to this reason, as well as the constant agitation of the Lancashire Cotton Industry against the depreciating Indian exchanges (1), the free coinage of silver in India was suspended in 1893 and further increase of monetary supply was stopped from that year.

Section:5: The end of the Great Depression and the changed International Monetary Situation 1893-1899.

The monetary stringency that caused the Great Depression in great Britain, at that time the financial and industrial centre of the world, helped to bring about its own remedy. The phenomenal development of cheque-banking in Great Britain during the last quarter of the 19th century economised the

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(1) " Indian Fiscal Commission Report, 1921-22". Chapter 10, paras. 152-171.

use of gold and thereby increased the volume of money to such an extent that it constituted a very substantial part of the monetary circulation of the country.(1) The cheque-money helped to maintain British prices and effective demand at a higher level than they would have otherwise attained by the effect of depression, if the monetary supply were comprised only of gold coins. If the depression could have run its course without its effect being counteracted by cheque-money, the fall of British demand would have been so great and the pressure for downward balancing by other gold-standard countries would have been so unbearable that it would have broken the gold standard fabric itself. It was the pegging of British demand at a comparatively higher level by cheque-money, despite the depression, that maintained to some extent the market of other countries and kept the gold standard in existence during these difficult years. Thus it was the cheque money that saw the gold standard through the Great Depression.

By the middle nineties the volume of cheque-money constituted such a large proportion of the monetary supply of the country that it began to affect the value of money to a much greater extent than gold itself. The monetary system became increasingly a sterling standard rather than a gold standard.(2) Mainly due to the augmentation of money supply by cheques, the fall of prices was arrested during the closing years of the century and an upward trend of prices made itself felt. At the

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(1) "The Meaning of Money", by H.Withers. Chapter 5.

(2) "The Economist", May 1, 1948. Article 'Sterling Area', p.699, para.2.

close of the century a climax was brought about when the South African gold mines began to pour in a huge quantity of newly mined gold and expanded the basis of the British credit structure. Cheque-money was multiplied manifold on the expanded gold base. This not only dispelled the monetary stringency, but made the money market easy and thereby stimulated British effective demand. From the beginning of the 20th century, the volume of expenditure began to run ahead of production and there was a fairly rapid rise of effective demand in all the countries subscribing to the currency system represented by gold and sterling.

SECTION 6. The Appreciating Indian Rupee and the Reintegration of the Indian Currency System with the International Gold Standard.

The suspension of silver minting in India in 1893 not only brought about a revolutionary change in her currency system, but also achieved a not altogether insignificant effect in the working of the gold standard itself due to the appreciation of the rupee in relation to gold. In spite of the budget difficulties caused by the falling exchanges and the representations of the Lancashire industry to remove the artificial exchange advantage of the Bombay industry, the Indian Government did not, at first, try to bring about any radical change in the silver standard. Instead, it endeavoured to introduce some kind of bimetallism by international agreements. The Indian Government sent delegates to the International Conferences of 1881 at Paris and of 1892 at Brussels, with the aim of supporting all proposals

to reconnect silver with gold.[1] But none of these conferences could arrive at any conclusion on that point. In 1892 the Government of India approached the Secretary of State for India with a proposal for closing its Mints to the free coinage of silver and making arrangements for the introduction of the gold standard.[2] The Secretary of State submitted the proposals of the Indian Government to a departmental committee, with Lord Herschell as the chairman, for examination. The committee upheld the proposals of the Indian Government and recommended the suspension of free minting of silver but the retention of the coinage of rupees on Government account in exchange for gold at a ratio of 1s.4d. per ounce. It also recommended the acceptance of gold at the Government treasuries in payment of public dues by the people at the same ratio.

The Government accepted the proposals of the committee and the Act of 1893 was passed, closing the Indian Mint to the free coinage of silver for the public. The Government undertook the further obligation of supplying rupees in exchange for gold coin and bullion at the rate of 1s.4d. to the rupee and empowered the people to pay their public dues, if they so desired, in sovereigns and half-sovereigns at the same rate. In other words, the maximum gold value of the rupee was fixed at this level but there was no provision to guarantee a minimum gold value for the rupee. It was expected that the suspension of further coinage of rupees,

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(1) "The Problem of the Rupee", by B.R.Ambedkar, London, 1923. p.135.

(2) "Report of the Herschell Committee, 1893". para.3.

while demand for rupees was increasing, due to the increase of Indian industry and trade, would gradually push up its value to 16 pence. As a matter of fact, the closing of the Mints made the rupee supply fall much short of the demand and was accompanied by an acute monetary stringency in India. The stringency commenced with the outbreak of famine in 1896 when the Bank of Bengal raised its rate from 4% in September 1896 to 8% in November of the same year. The stringency continued to be intensified until the discount rate went up to 13% in 1898 (1). While the volume of expenditure ran much ahead of production before 1893, it fell much short of production from 1896 onwards. It led to a sharp appreciation of the value of the rupee and the prices began to decline steeply.

Partly due to the appreciation in the internal value of the rupee and a decline in the world value of silver (2) the rupee exchnage began to rise and the face-value of the rupee became higher than its bullion value. The gap between the exchange and bullion value of the rupee began to widen with the lapse of every year as will be clear from the following table. (3)

Year	Metallic value of the rupee	Exchange value of the rupee
1894	11 1/3 d.	13 1/2 d.
1895	11 3/8 d.	13 3/8 d.
1896	11 7/8 d.	14 1/2 d.
1897	10 1/2 d.	15 1/4 d.
1898	10 3/8 d.	15 7/8 d.

(1) "Letter from the Bombay Native Shares, Stocks and Exchange Brokers' Association to the Chairman of the Indian Currency Committee, May 28, 1898." "The Fowler Committee Report, 1898", Appendix 5, p.20.

(2) The fall in the value of gold during these years also helped this development.

(3) "The Fowler Committee Report, 1898". p. 87, para. 63. and Fowler Committee Evidence. Question 238.

The rising exchnage value of the rupee conferred an exchange bounty on the imports from foreign countries and tended to stimulate it. While before 1893, Indian industries were enjoying a protection due to the falling exchange, after 1893, they were confronted with serious foreign competition- the exchange working in favour of the foreign producers. Indian industries were doubly hit by the general fall of prices and keen foreign competition which started from 1893.

The rising rupee exchange put the Indian export trade at a great disadvantage because it made the Indian goods costlier to foreign buyers and diminished their purchases. As the rise in the exchange rate in relation to the silver standard countries was more pronounced than the rise in relation to gold standard countries, Indian exports suffered more in the markets of the former than the latter. On the other hand, demand for Indian exports in the gold standard countries which constituted the bulk of India's market was rapidly increasing during these years due to the declining virulence of the Great Depression. These two factors probably neutralised each other so far as their effect on the Indian export trade was concerned.

There were other factors that were working towards a diminution of the Indian export trade. In the beginning (1893) Indian foreign trade was hampered by the existence of general trade depression in Europe and the banking collapse in U.S.A. and Australia (1). Moreover, in the Far East there was the war between China and

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(1) "India's Foreign Trade since 1870", by Dr. P. Roy. pp.57-66.

Japan which disturbed India's trade with the silver area. By 1895-96, there was a revival of business in Great Britain, the depression in U.S.A. and Australia was over and the war between China and Japan terminated. But in 1896-97, the abrupt end of the monsoons brought the country to the verge of famine (1). It was followed by the failure of the winter rains and a devastating earthquake along the eastern side of the country. Famine broke out in vast areas necessitating suspension of exports of food grains. But, allowing for the trade restricting effects of all these factore, it must be admitted that exchange appreciation was probably the most potent factor in restricting Indian foreign trade during this period. Though quantum figures of trade of these years are not available, yet due to the absence of any serious price fluctuations (general index of Indian wholesale prices with 1873 as 100, stood at 104 in 1880, 100 in 1890, 104 in 1895 and 116 in 1900 (2), there was no wide divergence between volume and available value figures of trade, given below. Trade in this period was stagnant and there were even years of retrogression (3).

(In millions of rupees)

Years	Merchandise import	Merchandise export	Totals
1893-4	770.21	1,065.03	1,835.24
1894-5	735.29	1,089.14	1,824.43
1895-6	729.37	1,143.35	1,872.72
1896-7	761.17	1,039.84	1,801.01
1897-8	736.47	976.33	1,712.80
1898-9	721.01	1,128.00	1,849.01
1899-0	753.04	1,090.83	1,843.87

The currency position from 1893 onwards was avowedly transitional and provisional and some definite action still

(1) "India's Foreign Trade since 1870", by Dr.P.Roy, pp 57-66.
(2) "Index Numbers of Indian prices" by F.J. Atkinson.
(3) Compiled from "Statistical Abstract", relating to British India.

remained to be taken. This was hastened by the representation of the Calcutta Chamber of Commerce, which was inconvenienced by the starving of the money market through the closing of the Mints and the temporary suspension of the sale of Council Bills, resulting in a very high rate of discount. This led to the appointment of the Fowler Committee in 1898.

There were two alternative schemes for establishing the gold standard considered by the Fowler Committee. Mr.Lindsay, Deputy Secretary and Treasurer of the Bank of Bengal, submitted a scheme for a gold standard without a gold currency, while the Government of India submitted another scheme of a gold standard with a gold currency before the Committee.(1) The latter upheld the proposal of the Government of India and made the following recommendations: (a) Like the Australian branches of the Royal Mint there was to be free minting of sovereigns and half-sovereigns in India; (b) The rupee was to circulate with unlimited legal tender character side by side with gold currency. (c) The existing obligation of the Government to sell Council Bills to an unlimited extent and their encashment in rupees was to continue. To fulfill this obligation the Government was to retain the exclusive right of coining rupees. The profit on the coinage of rupees was to be formed into a separate reserve called the gold standard Reserve. (d) The Government was to undertake the obligation of supplying gold, specially for export purposes when the balance of trade went against India.

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(1) "The Fowler Committee Report, 1898". paras. 42-47.

The Government of India accepted the report of the Fowler Committee almost in its entirely and passed the Act of 1899 making sovereigns and half-sovereigns unlimited legal tender in India at the rate of 1s.4d. to the rupee or fifteen rupees to the pound. This measure merged the Indian currency in the International Gold Standard system from 1899.

Section 7: The Expanding Monetary Supply under the International Gold Standard Regime, 1899-1914.

The increasing monetary supply of Great Britain, partly brought about by the development of cheque-banking and partly by the increased gold supplies from the South African mines, persisted continupusly for the first fourteen years of the present century. It maintained a slowly rising price-level and a profitability of productive enterprises throughout this period. The labour and resources that suffered unemployment during the last quarter of the 19th century began to be rapidly re-employed and production went on expanding, increasing pari passu the income of the country. Despite this increase in economic activity, the volume of money during this period ran ahead of expanding production. In consequence, demand for goods was always in excess of their supply or, in other words, effective demand was greater than the level of economic activity. The monetary situation during this period was, therefore, exactly the reverse of what it was during the previous twenty-five years. After 1900, a sellers' market developed again and due to the excessive pressure of demand the sellers could dispose of their goods at terms more profitable to themselves.

The expanded British demand for goods (i.e. the big and growing effective demand) was not and could not be restricted within the internal market. A good part of it overflowed the national boundaries and was utilized to purchase foreign goods. This British demand stimulated international trade and foreign productivity. Moreover, the overflowing part of the British demand (or market) constituted a very substantial part of the world demand (or market) and was the deciding factor in determining the fortunes of the world economic activity and world trade, and thereby the functioning of the gold standard system itself. The strength of this British demand and its position in the world economy was forcefully demonstrated by the American crisis of 1907-8 when U.S.A. ceased to purchase anything from the outside world, but continued her exports unabated and made the rest of the world her debtors. Great Britain met the unfavourable balance of herself and the rest of the world by sacrificing part of her gold reserves, as well as by recalling partly from U.S.A. part of her short-term loans by a high bank rate policy. In the process, Great Britain had to extend loans to many countries to meet their deficit balance. This was, however, a stop-gap arrangement and simply proved the financial strength of Great Britain in the short loan money market of the world. More significant was the strength of the British import market, which could more than make good the complete collapse of the American market. It enabled all other countries to earn sufficient foreign exchange to maintain their balance of payments equi-

librium and stable exchange rate with sterling and thereby with gold. The British import markets were thus the mainstay of the gold standard, world trade and world economic activity. The gold standard itself became in essence the sterling standard. Any other country of the world could attain a high level of international trade and domestic economic activity simply by maintaining a stable exchange rate with sterling.

Section 8: The Gold Exchange Standard in India, 1899-1914.

From 1899, the Indian Government began its attempt to put sovereigns and half-sovereigns into active circulation. They instructed their Post Offices to pay money orders in sovereigns and Paper Currency Offices to meet the demand for encashment of notes in gold coins, unless these were refused by the public. The district treasuries and railways also were instructed to make payment in gold coins if people were willing to accept them. These attempts to put gold into circulation continued during 1900 and 1901 and a substantial amount of gold coins amounting to £6,750,000 passed into public hands. But one half of the gold thus put into circulation returned to the Government, being paid by the public in discharge of their dues to the Government. A considerable part of the remaining half was exported and a substantial amount was believed to be with bullion dealers.(1) In the meantime, negotiations were being carried on to start a Mint to coin sovereigns and half-sovereigns, but due to the

(1) "Indian Currency and Finance", by J.M.Keynes, Chapter 2.

hostility of the British Treasury, these proved abortive. For both these reasons the Government was forced to give up any further attempts to put gold coins into circulation.(1) The gold that accumulated in the reserves of India was shipped to England to be kept, with other gold reserves, earmarked in the Bank of England.(2)

After these failures, the Indian Government took advantage of that part of the recommendations of the Fowler Committee which permitted the Government to coin rupees to satisfy public demand, to relieve the stringency of the money market. The sale of Council Bills was begun and to meet these, rupee coinage was resumed and was maintained at a steady rate up to the end of 1904. The silver bullion reserve was sufficient to meet this demand, but in 1905 there was an abnormal demand for Council Bills and to meet the latter, the rupee reserve was nearly exhausted. The stock of silver bullion also ran short and the Government had to buy silver with part of the gold reserves in London and ship it to India. In the meantime, the rupee reserve in India sank to danger level and the price of the Council Bills had to be allowed to rise to 1s.4$\frac{5}{32}$d. per rupee. But the silver bullion arrived and the Mint worked overtime and the supply of rupees increased very rapidly and was not only sufficient to meet the demand, but, by the end of 1906, became much greater than what was required for a very long time to come.(3)

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(1) "Chamberlain Commission Report, 1914". paras. 53-76.

(2) Ibid. paras. 77-101.

(3) Ibid. paras. 12-43.

But the fact that the Government had to allow the exchange to rise above the maximum level, injured its vanity. The Government went on coining rupees to such an extent that under no imaginable circumstances would there be a shortage of rupees again. For the whole of the financial year 1906-7, they continued their minting. By the end of October, came the American financial crisis. America, during and immediately after the crisis, sold to the outside world immensely more than what she bought from outside and made the rest of the world suffer a steep unfavourable balance in relation to her. The balance of trade turned strongly against India and the usual demand for Council Bills completely disappeared. To meet the Home Charges, the Secretary of State could sell Council Bills of three millions of rupees only, by allowing the lowest exchange rate 1s.$3\frac{29}{32}$d. per rupee. Thereafter buyers could not be found even at that rate. He had to withdraw from the exchange market and meet the Home Charges from the gold reserves. But his complete withdrawal also did not succeed in maintaining the exchange which continued to fall and reached 1s.$3\frac{11}{16}$d. per rupee by November 25th, 1907.(1) This rate was lower than the lowest specie point and it could not have happened if the rupee had been a gold coin.

To save the exchange rate, more drastic steps were urgently required. In December of 1907, the Government offered to sell Reverse Councils or Sterling Drafts, to an unlimited extent at the minimum rate of 1s.$3\frac{29}{32}$d. per rupee on the Secretary of State, who was to meet these from the gold reserves. There

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(1) "Chamberlain Commission Report, 1914". paras. 12 to 43.

was an urgent demand for these Sterling Drafts and their total amounted to £20 million within a year. The Gold Reserves of the Government fell from £31 million to £11 million within one year while the corresponding amount of rupees was withdrawn from circulation. There was another invisible agent which worked to help the exchange. Railway and general loans to the aggregate amount of £14½ million were contracted in London by the Indian Government. Nearly £10 million was spent in England on purchasing materials and this did not help the exchanges. But to the extent of nearly £5 million, these loans were spent to purchase materials in India and these helped the exchanges. Hence the total assistance from reserves and loans amounted to £25 million, which was also the amount of rupees withdrawn from circulation. This ultimately turned the tide and by the middle of 1908, the demand for Council Bills revived.(1) Towards the end of the year 1909, the exchange fell again and Reverse Councils were offered promptly. From that time until 1914, the currency system worked smoothly without any further strain.

India built up a very sound gold reserve consisting of two sections. Out of the profits of the rupee coinage, a separate gold reserve, called the Gold Standard Reserve was created and kept in London and this, together with the Paper Currency Reserve, kept up the external value of the rupees and notes.(2)

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(1) "Indian Currency and Finance", by J.M.Keynes. Chapter 2, p.134.
"Chamberlain Commission Report, 1914". paras. 12-43.

(2) "Chamberlain Commission Report, 1914". paras. 77-118.

The system of currency that gradually evolved through these trials and tribulations may be expressed as follows in the words of J.M.Keynes:

"1. The rupee is unlimited legal tender, and so far as the law provides, inconvertible.

"2. The sovereign is unlimited legal tender at £1 to 15 rupees, and is convertible at this rate, so long as a Notification issued in 1893 is not withdrawn, i.e. the Government can be required to give fifteen rupees in exchange for £1.

"3. As a matter of administrative practice, the Government is, as a rule, willing to give sovereigns for rupees at this rate, but the practice is sometimes suspended and large quantities of gold cannot always be obtained in India by tendering rupees.

"4. As a matter of administrative practice, the Government will sell in Calcutta, in return for rupees tendered there, bills payable in London in sterling at a rate not more favourable than 1s.3$\frac{29}{32}$d. per rupee." (1)

Thus the second provision prevented the sterling value of the rupee from rising above 1s.4d. by more than the cost of remitting sovereigns to India and the fourth provision prevented it from falling below 1s.4d. by more than the cost of exporting gold. This meant, in practice, that the extreme limits of variation of the sterling value of the rupee were 1s.4d. and 1s.3$\frac{29}{32}$d. As sterling was during this period convertible into gold in unlimited amounts, without question, and gold could be

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(1) "Indian Currency and Finance", by J.M.Keynes, London, 1913. p. 6.

exported freely from England, the Indian system became in effect a gold standard.

With the perfection of the Indian monetary system its provision became widely known and freely copied by many other countries of Asia, Africa and Latin-America. The Philippines, Siam, Indo-China, Straits Settlements, Dutch East Indies established varieties of the Exchange Standard and secured stable exchange with gold. The Japanese currency system also was, in effect, an exchange standard. Thus during the first decade of the 20th century, the gold exchange standard became the prevailing monetary system of Asia - the silver standard being restricted to China only. Supplemented by the exchange standard, the monetary system of the world became unified into the International Gold Standard in the real sense of the term.

By linking her currency to gold, India made the rupee an instrument that could be interpreted in terms of almost all the currencies of the world - a unit in the world system. Stable rupee exchange rates brought India within the orbit of world wide multilateral trade that was developing during the last quarter of the 19th century in the gold standard countries of the world and was by-passing India to a degree. The world trade that was perfected by the close of the 19th century into a circle with all its multilateral ramifications began as bilateral trade from the beginning of the century and was connected with the British overseas investments.(1) When, with the increase of these investments, their incomes exceeded fresh ex-

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(1) "The Network of World Trade", League of Nations, Geneva, 1942. p.84.

ports of capital, Great Britain developed a favourable balance of trade in relation to her tropical debtor countries. The latter supplied primary products to Britain and serviced their loans by sending an excess of exports to Britain over their imports from her. At this stage, it was a bilateral trade between Great Britain and the tropics.(1)

The expanding demand of Great Britain for all types of goods could not be met solely by the tropical countries for any length of time. The economic development of Western Europe and U.S.A. in the seventies enabled Great Britain to procure from them more and more of her import requirements. Great Britain became the most important market for the products of U.S.A., France, Sweden, Denmark and Holland. As long as the economic development of these countries was restricted to primary goods, they continued to purchase traditional British manufacturing goods, such as textiles, apparel etc. From the eighties, however, they themselves built up these industries and restricted the corresponding British products by import duties. In time, the British balance of trade became unfavourable in relation to these countries. But during this period, British imports from tropical countries began to decline and her unfavourable balance of trade with them was transformed into a favourable balance.(2) It is interesting to note that this change took place despite the fact that the servicing charge for foreign loans of tropical countries went on increasing. The servicing ch-

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(1) "The Network of World Trade", League of Nations, Geneva, 1942. p.84.

(2) Ibid.

arge for foreign loans of U.S.A. did not increase during this period but, nevertheless, she increased her favourable balance of trade with Great Britain.(1) In Western European countries British investments were negligible and these countries did not require any favourable balance to service their foreign loans. But, nevertheless, they developed a favourable balance in relation to Great Britain and fitted themselves into the trade system in between the Tropics and Great Britain. Thus, we find that though the world trade began from the necessity of creating a favourable balance to service the foreign loans of the tropical countries, yet it soon surpassed that limit and developed into international trade par excellence based on a geographical division of labour - each country producing goods in which it had a comparative cost advantage.(2)

Up to this point, the world trade was of triangular type in which U.S.A. and continental Europe financed their increasing purchases of primary goods from tropical countries by a net export to Great Britain, who met this deficit balance from her dividend and interest receipts from investments in the tropical countries. The latter, with the surplus of their exports to U.S.A. and continental Europe, not only serviced their foreign loans but paid for the balance of imports from Great Britain.(3) In the 1890's , this triangular trade became quadrangular 'when the Regions of Recent Settlement in the Temperate Belt' - i.e. the British Dominions and South American countries

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(1) "The Network of World Trade", League of Nations, Geneva, 1942. p.84-85.

(2) Ibid.

(3) Ibid. p.85.

came on the scene. These areas first developed agriculture and then mining and industries on the most scientific lines and in agricultural exports competed with U.S.A. so successfully that the latter was ousted from the British and continental European markets. But these countries were in need of transportation equipment and other capital goods from U.S.A. which, however, needed very little of their products. They had, therefore, a net unfavourable balance of trade with America as well as with the tropical countries - the last mentioned supplying them with primary products. The Regions of Recent Settlement paid for the net imports from the tropics and U.S.A. by a net export of raw materials and foodstuffs to Germany and other industrial countries of Europe. Germany, again required raw materials and foodstuffs from these Regions as well as from the tropical countries. She paid for this net import by making a net export to the rest of Europe. The European countries (minus Germany) paid for their net imports from Germany partly from their interests and dividends on overseas investments and partly by their favourable balance with Great Britain.(1)

Thus, by the close of the 19th century, world trade became fully multilateral. The course of this trade formed a complete circle in which the different groups of countries, starting from the tropics, were contiguously placed, each area having a favourable balance in respect of all others preceding it.

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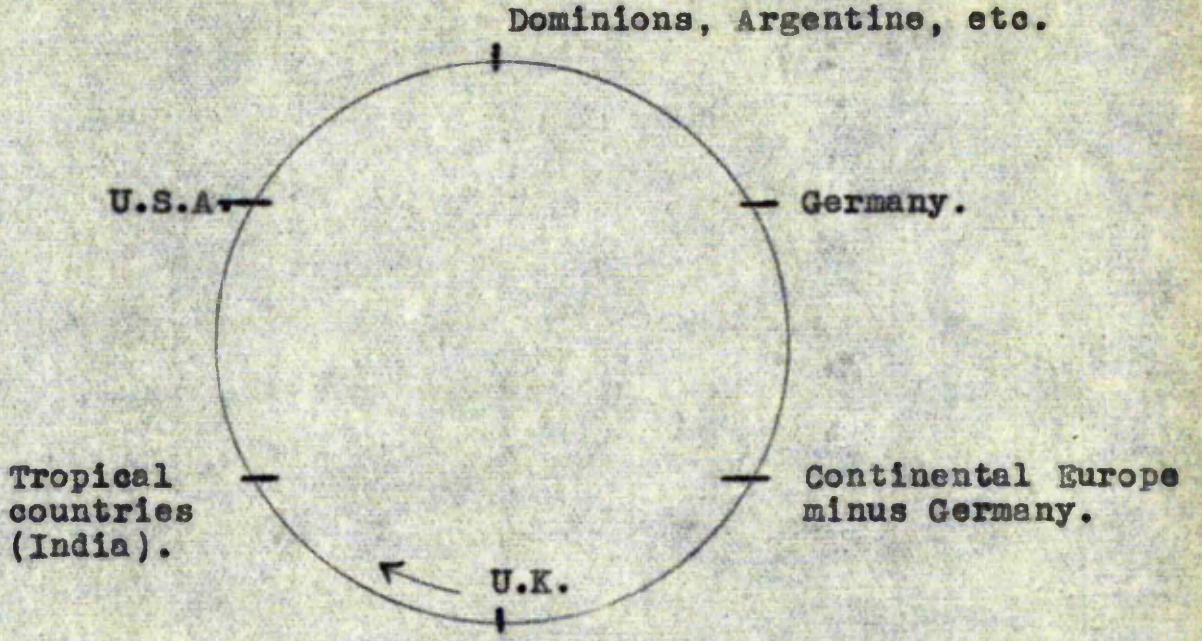
(1) "The Network of World Trade", League of Nations, Geneva, 1942. pp.85-86.

(1)



In the above figure, if we trace the circumference of the circle in the arrow direction from the tropical countries, we shall find that every group indicated thereon has a favourable balance with all other groups in front of it. Great Britain was the terminal point as she met her net unfavourable balance with her proceeds from foreign investments. That the volume of this trade was much greater than the net proceeds from the British foreign investments was indicated by the fact that the total volume of favourable balance of the tropical countries far exceeded the amount needed for servicing their foreign loans. Now, this increase was possible, by activating, through multilateral trade, the demand for tropical products of all the countries in front of the tropical areas indicated on the circle. If there were no multilateral trade, the volume of exchange would be restricted to a much smaller amount,

(1) A simplified form of the figure on p.78 in "The Network of World Trade", League of Nations, Geneva, 1942.

capable of being bilaterally adjusted, and the world would have been much poorer by being deprived of the advantages of the international division of labour.

Now, this multilateral trade was possible, only if there were multilateral means of international payments, i.e. if each currency could be freely turned into any other currency at reasonably stable exchange rates. If there were no stable exchanges, multilateral settlements of international payments would become so risky that they would be given up altogether and trade would be reduced to bilateral transactions and shrink in consequence. The International Gold Standard, by maintaining the stability of exchange rates, provided the means of multilateral settlements and thereby facilitated multilateral trade. This was the reason why the multilateral trade system in the last quarter of the 19th century comprised only the gold standard countries. During these decades, India could not participate fully in the development of world multilateral trade because of the absence of a stable international means of settlement caused by her fluctuating exchanges. When, however, stable exchanges were attained from 1900 onwards, India got the means of settlement on a multilateral basis and the entire potential world demand for Indian exports was released and made effective. This naturally stimulated Indian exports and she participated in the world multilateral trade to the fullest extent.

While her membership of the International Gold Standard system provided India with the means of participating in the multilateral world trade, the prosperity boom in Great Britain from 1900 to 1914 supplied the contents or materials of that

trade. From 1900 onwards effective demand began to run ahead of British productive activity and this very fact increased the profitability of British productive enterprises, which went on expanding continuously. Though effective demand was in excess of the volume of production, yet the level of British production did not attain the maximum productive capacity even at the end of this period. This peculiarity imparted a particular efficacy to monetary stimulus in increasing British productivity. Increasing effective demand backed by increasing productivity stimulated world trade and thereby increased the economic activity of the whole world. Taking manufacturing production as an index of economic activity, we can form a rough idea of the intensity of this British stimulus from the following table :- (1)

Indices of Manufacturing Activity.
(Base: 1913 = 100)

Period.	U.K.	World.	India.
1871-75	49.0	22.4	.... (2)
1876-80	50.0	24.5	....
1881-85	57.3	30.4	....
1886-90	61.3	36.8	....
1891-95	64.6	42.6	....
1896-00	74.3	53.6	53.5
1901-05	77.3	67.0	68.9
1906-10	83.1	79.9	85.0
1911-13	93.1	94.3	97.1

The expansion of the British market meant, in effect, the expansion of the world market, so much so that the total collapse of the American import market in 1907-8 could not ser-

(1) Compiled from the tables on p.130 of "Industrialization and Foreign Trade", League of Nations, 1945.

(2) Not available.

iously or permanently damage or dislocate the world trade or industry. The expanded British demand in combination with India's membership of the International Gold Standard benefitted Indian foreign trade in two respects. The terms of Indian trade with the rest of the world improved considerably and her volume of trade increased immensely.

It is noteworthy that the rise in prices during this period was greatest in India as is shown by the fact that the level during the quinquennium 1907-11 as compared with the quinquennium 1894-8 showed an increase of 40%, while corresponding percentage rises being 21% for U.K., 38% for U.S.A. and 20% for Australia.(1) In Indian index numbers there is a preponderance of agricultural goods while manufacturing goods preponderate in those of advanced countries. The special rise of Indian prices was due to the special rise of agricultural, as compared with manufacturing, prices in the world market. This was mainly due to the economies of large scale production in manufactures with the expanding scale of production. The Indian imports consisting mainly of manufacturing goods and exports being mainly agricultural products - this meant a strongly favourable term of trade for India.(2)

The second effect of the gold standard and expanded British demand was the phenomenal development of India's foreign trade from 1900 to 1914. The following trade tables will

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(1) "Report on the Enquiry into the Rise of Prices in India (1914)", by K.L.Datta. p.29.

(2) "Index Numbers of Indian Prices 1861-1931", by F.J. Atkinson.

give an idea about the immense increase of Indian trade.[1]

Increase of International Trade in Manufactured Articles from 1871-1913.
(Quantum 1913 - 100)

Period	World Total Trade	Great Britain Im port	Great Britain Ex- port	India Im port	India Ex port
1871-75	....	26.7	44.8	....[2]	....
1876-80	32.1	38.1	43.5	....	....
1881-85	40	44.3	54.9	....	....
1886-90	45.1	49.9	60	....	....
1891-95	45.9	57.5	57.3	....	....
1896-00	48	64	55.4	....	....
1901-05	63.2	88.7	67.9	56.1	....
1906-10	77.9	80.9	82.2	69.9	....
1911-13	95.6	95.9	96	87.7	....
1913	100	100	100	100	....

As Indian quantum export figures of this period as well as import figures before 1901 are not available we cannot compare the increase of Indian trade of this period with the previous period. But taking the import figures as representative, the conclusion may be hazarded that from 1901 to 1913, Indian trade nearly doubled itself in magnitude and the rate of increase was greater than that of Great Britain as well as of the world. The extraordinary nature of the increase of Indian trade during this period is corroborated by the general quinquennial value figures of Indian trade given on p. 107. The available price datum indicates that from 1865 to 1913, price-changes were not of considerable amplitude. The general index number of Indian wholesale prices (base:1873 - 100)[3] stood at 107 in 1865, 116 in 1900 and 122 in 1910. Due to

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(1) Industrialization and Foreign Trade : League of nations 1945, page 157, 162 and 163.
(2) Quantum figures not available.
(3) Index Numbers of Indian prices by F.J. Atkinson.

this reason price changes did nor prevent a rough correspondence between value and volume of trade during this period.

(1)

The Growth of Indian Foreign Trade from 1864-69 to 1909-14

(In lakhs of rupees)

Quinquennial Average	Imports	Exports	Total
1864-5 to 1868-9	31,70	55,86	87,56
1869-70 to 1873-4	33.04	56,25	89,29
1874-5 to 1878-9	38.36	60,32	98,68
1879-80 to 1883-4	50,16	79,08	129,24
1884-5 to 1888-9	61,51	88,64	150,15
1889-90 to 1893-4	70,78	104,99	175,77
1894-5 to 1898-9	73,67	107,53	181,20
1899-0 to 1903-4	84,68	124,92	209,60
1904-5 to 1908-9	119,85	165,44	285,29
1909-10 to 1913-4	151,67	224,23	375,90

Two facts go a long way to explain the stagnation of Indian trade before 1900 and its phenomenal development after that year. Indian currency management consisted of a fluctuating rupee exchange with gold before 1900 and stable exchange after 1900. This fact, together with British depression in the previous period and the prosperity boom during the later period are sufficient to explain the difference. The phenomenal development of Indian trade and industry from 1900 to 1914 was thus mainly incidental to the British prosperity boom of this period. India attained her monetary objective partly through her attachment to the gold standard but mainly through the monetary policy of the major economy of that time.

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(1) Compiled from Statistical Abstract relating to British India.

The Problem of the Standards of Indian Currency

Chapter III.

Indian Currency Policy and Problems: The Suspension, Restoration and Liquidation of the Gold Standard. 1914-1931.

C H A P T E R III.

INDIAN CURRENCY POLICY AND PROBLEMS

The Suspension, Restoration and Liquidation of the Gold Standard . 1914-1931.

Section 1: Monetary Repercussions of World War I.

The first World War created such a situation that it was no longer possible to continue monetary management according to the gold standard rules and thereby maintain exchange stability and balance of payments equilibrium. The International Gold Standard which prevailed for such a long period before the outbreak of the war, was a means of multilateral settlement of international trade transactions - using the word trade in the widest economic sense, comprising exchange of goods and services and capital movements. The gold standard could, therefore, exist only as long as international trade existed and was free enough to attain equilibrium. But the Great War destroyed all these foundations. Trade between the belligerent countries was out of the question. For four years and more, the production and distribution of goods was governed in the belligerent countries primarily by the exigencies of the war. The belligerent countries had to divert labour and capital from export industries to either battlefields or munition factories. On the other hand, their need for foreign imports remained the same, if not increased. Moreover, whatever little trade could be carried on, was made wellnigh impossible by blockade and shipping

shortage. International trade was, thus, not only drastically reduced but there was no means of attaining a balance of payments equilibrium. To meet their unfavourable balances, the belligerent countries had to sacrifice their gold reserves in the very early stages of the war and go off the gold standard.(1)

The neutral countries also could not remain on gold for long. As the belligerent countries had to send their gold to them in payment for their essential purchases, the neutral countries raised a huge superstructure of currency notes and bank money on the expanded gold base. Their money supply increased to such an extent that they could not maintain their gold ratios even with their augmented supply of gold. The importunate demand of the belligerents for more loans persuaded them to expand their credit structure beyond all normal proportion to their reserves and this in time compelled them to suspend gold payments and to resort to inconvertible paper money.(2)

Despite many stupendous obstacles, an attenuated international trade had to be carried on during the war. It was essential, for example for Great Britain to maintain the import of war supplies from America. Due to her inability to maintain exports and her rapidly disappearing gold reserves that provided

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(1)" Money," by D.H.Robertson, London, 1948. Chapter 6, pp 109 and 110.
(2) Ibid. p. 110.

the only means of payment, the dollar-sterling exchange rate fell briskly from £1 : $4.86 to £1 : $4.76 within a few months.[1] This increased the cost of war materials to Britain and raised the problem of meeting the price of the excess imports from America. Exchange was pegged at 4.76 to the pound, but this involved an unlimited offer of dollars by the British Government at that rate to the importers and others who needed dollars.[2] British capitalists owned a huge amount of investments in America before the war. The British Government bought the titles to these investments in exchange for sterling and began to sell them in America. With the dollar proceeds of the sale of these American investments the Government continued to meet its deficit balance. When all the investments were thus sold off, the British Government took a big loan from America to continue its foreign payments.[3] Thus, by the end of the war, America instead of being indebted to England, became her creditor for a colossal amount. This entire Anglo-American trade transaction was an international barter deal and the dollar-sterling exchange rate was an arbitrary loan-rate. When pegging was withdrawn in March 1920, the dollar value of sterling quickly fell to $3.4.[4] Bilateral barter deals of this type constituted the general pattern of international trade transactions during the war. In other words, money ceased to be managed to serve the needs of free international trade because there was no such trade.

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(1) "Babington Smith Committee Report, 1919". para. 19.
(4) Ibid.

(2) "Prosperity Decade: A Chapter from American Economic History, 1917-1929", by G.Soule, New York, 1947. p.253.
(3) Ibid.
(4) "Babington Smith Committee Report, 1919", para.19.

While the Great War created a situation in which international trade could no longer serve as a criterion of monetary management, the same situation demonstrated the possibility of managing money according to a new criterion. The belligerent governments, in their attempts to commandeer economic resources to prosecute war, soon came to the limit of taxation and straight borrowing and were obliged to have recourse to the manufacture of paper money.(1) In all cases, paper money was able to mobilise real resources for the prosecution of war to a very great extent. Thus, paper money was found capable of directing economic activities in a desired direction and attaining a set purpose.

Much more significant than the diversion of productive activities from one line to another was the power that paper money demonstrated in stimulating production itself. The war caused a terrific destruction of productive equipment and complete chaos in the productive organization in Europe. Mainly due to this reason, the volume of overall production of the world suffered a diminution. But, in countries where productive equipment did not suffer physical destruction or dislocation, the volume of production, under the stimulus of rising prices brought about by increasing paper money, increased considerably.(2) This was an unmistakable sign that paper money had the power of stimulating production. The indices, on page 112 of this thesis, of manufacturing production of the

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(1) "Money", by D.H.Robertson, London, 1948. p.108.

(2) "Industrialization and Foreign Trade", League of Nations, 1945. pp.134 and 135.

world, at the beginning and end of the war, of some selected European countries suffering from war destruction and dislocation, as well as of countries that were comparatively immune from war devastation, will bear out this general inference.

Annual Indices of Manufacturing Production. (1)

(base - 1913)

	1913	1920
World.	100	93.2
War-devastated Europe.		
Russia.	100	12.8
Germany.	100	59
France.	100	70.4
U.K.	100	92.6
Other Countries.		
Japan.	100	176
New Zealand.	100	125
U.S.A.	100	122.2
India.	100	118.4
Norway.	100	101.9
Australia.	100	100.5

It was, thus, at least vaguely apparent that if paper money could mobilise real resources for the purposes of the war, there was no reason why it should not be able to mobilise resources for other purposes; and if war demand, made effective by paper money, could stimulate productive activity, there was no reason why consumption demand, made effective in a similar manner in peace-time, should not be able to stimulate the production of consumption goods.

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(1) "Industrialization and Foreign Trade", League of Nations, 1945. pp.134 and 135.

Section 2: Indian Currency during World War I.

Although India was an active participant in the war, her currency experience during these years was more similar to that of neutral countries than belligerants. After an initial loss of confidence by the impact of the war and a quick recovery from it, there ensued a strong demand for the Indian currency originating from the Allies' demand for Indian goods. Large quantities of various Indian materials, such as sand-bags, hides etc. needed for the Eastern Theatres of War, were bought by the Indian Government on behalf of His Majesty's Government. In addition to this, arrangements had also to be made for the financing of purchases in India on behalf of some of the Dominions and Colonies. The combined effect of these factors was to create a heavy demand for Indian goods and, therefore, for Indian currency.(1)

While the export trade of India was thus expanding rapidly, import trade lagged far behind and it declined continuously throughout the war years. Imports from Central European countries were naturally suspended and the Allies' productive organization was concentrated more and more on war needs. Hence, though raw materials and foodstuffs were bought in greater and greater quantities by the Allies, yet they could not export any goods to India. This excess of exports over imports created an ever-increasing favourable balance for India,(2) and a great demand for Council Bills.

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(1) "Babington Smith Committee Report 1919". paras.9-11.

(2) Ibid. paras.10 and 11.

Balance of Trade in Merchandise during the War Years in Lakhs of Rupees. (1)

Year	Import	Export	Balance
1913-14	183,25	244,20	60,95
1914-15	137,93	177,48	39,55
1915-16	131,99	192,56	60,57
1916-17	149,63	237,10	87,47
1917-18	150,42	233,44	83,02
1918-19	169,03	239,32	70,29

Under pre-war conditions Council Bills were sold in London for sterling which was then deposited in India's account with the Bank of England. A part of it was kept in London as a gold reserve to meet Reverse Councils when balance of payments became adverse to India. Another part was utilised to buy and transport gold bullion to India. But, with the commencement of the war Great Britain suspended the gold standard and stopped the export of gold. Against this restriction only a small part of the sterling which resulted from the sale of Council Bills could be used to buy and ship gold. The difficulties in purchasing silver from outside were greater still as will appear from discussions in the following pages. The following table on the next page gives India's imports of treasure during the pre-war quinquenium and during the war period and shows a sudden diminution of gold and silver after the outbreak of the war. In value, the average gold and silver imports of India during the war was not much below one-fourth of the pre-war years.

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(1)"India's Foreign Trade since 1870", by p. Roy, London, 1934. p.89.

Net Imports of Treasure on Private Account (1)

Year	Gold & silver coin and bullion in £	Year	Gold & silver coin and bullion in £
1909-10	20,688,000	1914-15	12,313,000
1910-11	21,700,000	1915-16	6,984,000
1911-12	28,706,000	1916-17	1,357,000
1912-13	29,435,000	1917-18	15,277,000
1913-14	19,713,000	1918-19	53,000
Total :	120,242,000	Total :	35,984,000

As gold and silver in exchange for sterling could not be procured in the requisite quantity, India's balance of sterling began to accumulate and stood at £240 million at the end of the war. This deal did not, therefore, represent a bilateral trade transaction nor was the amount of £240 million a trade balance, but it was unilateral loan transaction and the amount involved was simply a loan from India to Great Britain. The suspension of gold payments by Great Britain and the stoppage of exports of gold, therefore, imperceptibly put India off the gold standard (2) and the monetary management of India ceased to be regulated for the needs of international trade.

The sterling balance of £240 million was adjusted by the encashment of Council Bills of the same amount in India in terms of rupees and rupee-notes. This involved an increase of money supply in India and there was a measure of inflation. The rise in prices did not apparently lead to any appreciable increase in agricultural production but there was a noticeable increase in manufactured production. The exports of manufactures

(1) "Babington Smith Committee Report 1919" para 14
(2) Ibid.

ures which constituted 22.4% of the total export trade in 1913-14, rose up to 36.6% in 1918-19.(1) There were significant developments in the cotton, jute, leather, iron and steel industries.The rise of prices, however, had less real effect on net increase of production than in diversion of production from Indian consumption goods to war exports. Indian monetary management during the war was, therefore, designed to finance the war-loan of £240 million and to mobilise the equivalent Indian resources for war purposes - a situation not dissimilar to the financing of war with paper money in the other belligerent countries during these years.

The sterling exchange mechanism continued to function smoothly until the end of 1916 when a difficulty of an exceptional nature arose. A heavy demand for Council Bills, and in consequence, for Indian currency necessitated a big expansion of the supply of both silver rupees and rupee-notes. Rupee-notes, however, were convertible into silver rupees but these paper notes increased relatively to such an extent that they came to the verge of inconvertibility. To increase the supply of silver rupees, the Indian Government had to make heavy purchases of silver for coinage to the extent of 538 million ounces up to the beginning of the year 1916.(2) From that year, however, the value of silver began to rise rapidly and the Government began to find increasing difficulty in procuring more silver. There were several reasons for this scarcity and the rise in the

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(1) "Indian Economics", by G.B.Jather and S.G.Beri, Bombay, 1945. p.202.

(2) "Babington Smith Committee Report 1919". p.17.

price of silver. In the first place, on account of political disturbances the silver production in Mexico, the most important silver producing country in the world, was completely disorganized, and chiefly because of this, the world production of silver fell from the pre-war average by an amount of 43.6 million ounces out of the average total of 50.5 million ounces of the world's total annual output.(1) Secondly, the world demand for silver, especially for coinage, became more and more acute. Coinage of silver in the British Empire required 108 million fine ounces per year during the war, while the pre-war quinquennial average was only 30.5 million fine ounces. Other conntries, especially belligerents, absorbed similarly big consignments of silver for coinage. The conserving of gold by the belligerents for war purchases led them to increase their demand for silver coinage.(2)

The following list of silver prices shows a continuous rise in the price of the white metal from 1915 to 1920:-

(Price per fine ounce)(3)

1915	27½ pence
1916	37 "
1917 (August)	43 "
1917 (September)	55 "
1919 (May)	58 "
1919 (December)	78 "
1920 (February)	89 "

43 pence per ounce is the silver par of the rupee. At this value of silver, the metallic value of the rupee becomes

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(1) "Babington Smith Committee Report 1919". para.15.

(2) Ibid. para.16.

(3) Ibid. para.18.

equal to its exchange value at 1s.4d. and this par was attained in August 1917. The rise in the price of silver bullion in the rupee above its face-value made the sale of Council Bills at 1s.4d. per rupee an impossibility because of the danger of rupees being melted down and sold for bullion. Hence, the rate of exchange had to be allowed to rise to correspond with the rise in the value of silver. The following table shows the continuous rise of the exchange rate.(1)

	s. d.
1917 January	1. 4¼.
1917 August	1. 5.
1918 April	1. 6.
1919 May	1. 8.
1919 August	1.10.
1919 September	2. 0.
1919 November	2. 2.
1919 December	2. 4.
1920 January	2. 6.
1920 February	2.10¼.
1920 March	2.10
1920 April	2. 8.

The rises in exchange rate were effected by the control of the supply of Council Bills by the Indian Government. By allowing these rises in the exchange rate, rupees were saved from the melting pot, but at the same time the prices of Indian exports to British purchasers were made very much higher. These rises in exchange rate hastened the accumulation of India's sterling balance and probably made the amount double what it would have been if the exchange rate had remained at the previous level. In the Indian economy, the rise of prices was much less serious because of the encashment of a smaller volume of Council Bills than would have been necessary

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(1)"Babington Smith Committee Report 1919". para.12.

if the rupee-sterling exchange rate had not risen. Indian currency was thus managed during the war primarily to finance the war exports or the sterling loan which accumulated mainly at the cost of Indian inflation and partly by turning the exchange rate against Great Britain. The Indian exchange rate did, therefore, materialize as an arbitrary sterling loan rate and had no connection with the potential trade situation of the country.

Though the exchange rate of the rupee was raised pari passu with the rise in the value of silver, yet this did not appreciably arrest the immense increase of currency supply in India. To meet its own war expenditure, the Government of India had to float huge war loans and had to help itself by manufacturing currency notes. While before the war notes constituted only a minor fraction of the currency circulation of India, they became nearly equal to silver coins at the end of the war and the absolute increase of note circulation was greater than that of silver rupees, as will appear from the table below:-

(1)

Currency Circulation in India.

(In lakhs of rupees.)

Average for 5 years.	Rupees.	Notes.	Total.
1909-10 to 1913-14	8,77	3,01	11,78
1914-15 to 1918-19	22,08	16,72	38,80
1919-20	20,09	20,20	40,29

The above figures indicate only the annual absorption of rupees and notes in the Indian economy. The gross circula-

(1) "Indian Economics", by G.B.Jather and S.G.Beri, Bombay, 1945. Vol.II. p.295.

lation of notes increased from 65.5 crores in 1913-14 to 171.6 crores in 1919-20 while active circulation increased from 46.6 crores to 151.1 crores between the two years.(1) This precipitate increase of money supply led to a corresponding increase of Indian prices:

Index number of Wholesale Prices in India and Great Britain. (2)

Year.	Calcutta 1914 = 100.	U.K.Board of Trade 1913 = 100.
1913	...	100
1914	100	100
1915	112	127
1916	128	160
1917	145	206
1918	178	226
1919	196	242
1920	201	295

The comparatively smaller rise in the Indian prices is explained by the rise of the rupee exchange in terms of sterling. The rising prices undoubtedly created distributive injustice within the Indian society, but by increasing the profitability of business enterprises, they stimulated Indian production very significantly. India was one of the few countries that recorded a very pronounced increase of manufacturing production and thereby demonstrated the power of paper money in stimulating productive activity.(3)

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(1) "Indian Economics", by G.B.Jather and S.G.Beri, Bombay, 1945. Vol.II. p.294.

(2) Ibid. p.337.

(3) The index of manufacturing production rose to 118.4 in 1920 from 100 in 1913. "Industrialization and Foreign Trade", League of Nations, 1945. p.135.

Section 3: The Post-War Monetary Situation and the Restoration of the Gold Standard, 1919-25.

The miracle that paper money performed during the war was not terminated even after the end of the war. Many indigent governments of war-torn Europe found in paper money the easiest and, in some cases, the only practicable method of taxing their people and they continued to run their tottering administrations by manufacturing more and more paper money.(1) The war had already led to a huge increase of money supply all over the world with its consequent inflation. In some belligerent countries, such as Germany, Russia and Poland, there was an inordinate increase in the supply of money and prices rose to astronomical heights. In others, the inflation, though severe, was not astronomical; price advances reached magnitudes of the order of 300% to 600%. In some other countries inflation, although real, was of still lower magnitude. In England, for example, between 1914 and 1920, the wholesale price level rose 195%; in Norway from January 1915 to December 1920, 128% and in U.S.A. from September 1917 to June 1919, 10%.(2) After the war, inflation continued in those countries where it had already been most rampant. War inflation and its further accentuation in many countries during the immediate post-war years led to various pathological economic developments of a highly unsatisfactory nature.(3)

Before the war, prices were rising all over the world, but not nearly so quickly as during and after the war. The rising

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(1) "Money", by D.H.Robertson, London, 1948. p.109.

(2) "Gold and the Gold Standard", by E.W.Kemmerer, New York, 1944. pp.108 and 109.

(3) "Money" by D.H. Robertson, London, 1948, p.117-128

prices ran ahead of increasing productive activity, yet there was always an excess of productive potentialities. The rising prices by increasing the profitability of productive enterprises stimulated the dormant resources of production and enlisted their application in the expansion of further production. Similarly, it might be suggested that rising prices after the war should have also increased the profitability of enterprises and continued the expansion of production. But the post-war production situation was fundamentally different. The devastations of the war had thoroughly disorganized the world's system of production and distribution. In Europe, there was extensive destruction of the physical equipment of production and the agricultural industry was completely out of gear. Moreover, the supply of money was already so great, the effective demand for goods so intense and profitability of productive enterprises so considerable that all the extant resources of production that were capable of producing anything were already fully engaged in production. There was no excess (short-run) potential productive capacity to be tapped by further monetary stimulus similar to that before the war. Hence, the continuance of the practice of manufacturing paper money by many countries after the war could not increase production any further but simply manifested itself in the form of rising prices.(1)

The continuous inflation in many European countries after the war, made the holders of money constant losers and there was a natural inclination of every person to spend his money as quickly as possible and hold his saving in the form of real

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(1) "Money", by D.H.Robertson, London, 1948. pp.110-119.

goods. This meant an increase of the velocity of money, acceleration in the rise of prices and a flight from money in general.(1) With the persistence of inflation, holding of money became such a losing affair that people were compelled more and more to give up monetary transactions and had to resort to barter, and the overall demand for money began to shrink. Difficulties in monetary transactions and inconveniences of barter restricted the volume of exchanges and thereby caused serious difficulties in the way of the expansion of production. By undermining the basis of contract, it tended to disorganize the productive system altogether. At the climax of inflationary developments, production was found to have shrunk considerably in the countries concerned. In 1920, the Russian index of manufacturing production, for example, sank to 12.8 from a base of 100 in 1913.(2) In 1923, the year of super-inflation in Germany, the index of German manufacturing production sank to 55.4 from 81.8 in 1922 and 100 in 1913.(3) The similar Hungarian index in 1923 fell to 56.6 from 80 in 1922, and the Polish index in 1924 was as low as 56.8 while in 1923 it was at 71.2 from a base of 100 in 1913.(4)

It was thus obvious that a mere increase of money could not stimulate further production when all the available factors of production were already fully engaged. Beyond this limit of full engagement, an increased supply of money was found to have a tend-

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(1) "Money", by D.H.Robertson, London, 1948. pp.117 and 118.

(2) "Industrialization and Foreign Trade", League of Nations, 1945. p.134.

(3) Ibid.

(4) Ibid. pp.136 and 137.

ency to disorganize and reduce production rather then to stimulate it. Increasing money supply in the post-war years became an obstacle to production, instead of a help. To increase production under the post-war circumstances, it was necessary to recreate and rehabilitate the physical equipment of production. No extent of increase of monetary supply could have enabled Europe to rehabilitate her productive system without importing equipment from abroad, which at that time meant U.S.A. But foreign goods could not be bought with manufactured paper money. Foreign loans could meet the situation, but foreign capitalists could not be expected to lend money to a country suffering under an inflationary pressure. Moreover, with the progress of inflation, foreigners set a much lower value on an inflating currency then the value to which it fell within the country (1) and consequently tended to raise the prices of foreign goods much higher than those of domestic goods, and thereby made the purchase of foreign equipment by an inflating country extremely costly. German inflation of 1923 put the whole of Germany up to auction, but even that could not help her to attain either balance of payments equilibrium or to rehabilitate her productive system. (2) Both goods and loans could be more easily obtained from U.S.A. by the European countries if they stopped inflation and rehabilitated their currencies back to the gold standard to which America returned immediately after the war. (3) The ever-growing inflation that was rapidly deteriorating the economic

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(1) "Money, by D.H.Robertson, London, 1948. pp. 119 and 120.
(2) Ibid. p. 122.
(3) Ibid. pp. 126-128.

systems in Germany, Austria and other central European countries to a state of complete collapse, set afoot a strong movement to restore the gold standard in the post-war years. The International Financial Conference held in Brussels in 1920, at which 39 countries including the most important nations of the world were represented, urged on all countries that had lapsed from the gold standard to return to it with all promptitude.(1)

Side by side with the movement to restore the gold standard, there developed another school of thought which upheld the creation of paper money as the most outstanding event in the whole evolution of the monetary system of the world, because it relieved humanity from the tyrannies of the yellow metal.(2) The exponents of this thought were not oblivious of the serious implications of potential inflation under paper money. As a remedy for this potential danger they advocated that all the governments of the world should be summarily deprived of money-making power altogether so that they might not create inflation. Misuse of this excellent instrument by the short-sighted governments of many countries did not warrant, in their opinion, a summary supression of it, but simply a more cautious and efficient handling of this facile mechanism. It is mainly for evolving sound principles for management of paper money that the theory of central banking received the closest attention of the economists of this school of thought. At their hands the theory of central banking attained its highest

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(1) "Gold and the Gold Standard", By E.W.Kemmerer, New York, 1944. pp.21 and 22.

(2) " A Tract of Monetary Reform", by J.M. Keynes, London, 1923 Chapter 4.

development in the twenties.[1] The Central Bank of a country was conceived as a parallel organization to the Government for controlling the economic affairs of the society. It was to be the monetary government of the country. The political government was not only to be deprived of money-making power but the Central Bank was also to be the keeper of the government's tax-money and the supervisor of its expenditure.[2] The government was not to own any shares in the Central Bank which was to be privately owned, but a national institution, not to be run with an eye to profit but to maintain the monetary stability of the country.[3]

Monetary stability was meant to include the stability of prices, profit and production.[4] In other words, the Central Bank of a country was expected to maintain economic activity at the maximum level.[5] This, it was to do, by providing re-discount facilities to other banks of the country when they needed more funds to finance the trade and industry of the country.[6] Thus, the paper money facilities of which the government was to be deprived, were to be made available to facilitate the productive activity of the country and to stabilise it at the highest

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(1) "Central Banks", by Kisch and Elkin, London, 1928.
(2) "Report of the Royal Commission of Indian Currency Finance 1926". paras. 83-90.
(3) Ibid.
(4) "A Tract on Monetary Reform", by J.M. Keynes, London 1923. Chapter 4.
(5) Report of the Hilton Young Commission 1926". paras 114-116
(6) Ibid.

level of activity. The economic opinion of that time was so much influenced by this school of thought that the existing Central Banks adopted the rules propounded by it, if they did not already conform to them. Appeals were sent from one international conference after another to countries that did not possess any Central Bank to organize one and to put their monetary system in order. Many new Central Banks did come into existence and took up the reins of their monetary government and undertook the function of maintaining the productive activity of their respective economies.

J.M. Keynes may be regarded as the leader of this new school of thought. He was logical enough to realize that if paper money was to maintain the stability of internal economic activity it could not, at the same time, maintain the convertibility of money into gold. He was,therefore, consistent in being a violent opponent to the restoration of the gold standard, which he dubbed a barbarous relic. But, strangely enough, the general body of economic opinion did not find any fundamental inconsistency in observing gold standard rules as well as maintaining internal economic activity by the monetary authority of a country. Far from appearing to be contradictory, the gold standard rules were taken as a healthy check to any monetary system in which paper money constituted the bulk of the circulating media. They grafted the gold standard rules on to the perfected theory of central banking; and over and above maintaining internal economic stability,Central Banks were charged with the responsibility of maintaining the gold con-

vertibility of their currencies and to maintain the balance of payments equilibrium of their respective countries.(1)

The restoration of the gold standard thus became the generally recognised objective. U.S.A. was off the gold standard only for a short time during the latter part of the war, and her reserve position was always very strong. She restored the gold standard in June 1919.(2) In 1922 when the Austrian currency was about to collapse by inflation, she received a loan from the Allied Countries through the good offices of the League of Nations, for currency stabilization. The external value of the Austrian currency at that time was much lower than its internal value, as was generally the case with inflating currencies. She pegged the external value of her money in terms of the dollar in the first instance and offered to convert her currency in/to dollars to any extent at that minimum rate.(3) Thus, by stabilising her currency at its lower external value, Austria could help herself with a little more inflation and finance herself with paper money for some time more until the less demoralised internal value fell to the lower external level. With the help of a loan from the League of Nations, Hungary stabilized her currency by following the method adopted by Austria, that is, by offering to convert it in/to dollars in unlimited amounts at the lower external value of its currency. Without any help from the League

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(1) "Report of the Hilton Young Commission 1926". para.114.

(2) "Gold and the Gold Standard", by E.W.Kemmerer, New York, 1944. pp.21 and 22.

(3) "Money", by D.H.Robertson, London, 1948. pp.125 and 126.

of Nations, Belgium raised a foreign loan xx xxxxxxf and stabilised her currency. France also made some private arrangements with a few big American financial houses for a currency stabilization fund. Russia was the only country which did not get any foreign loan for this purpose. But, by carefully regulating her foreign trade, which was a government monopoly, she managed to stabilize the external value of a new money called Chervonetz which was meant for external use only. The rouble was the Russian currency which circulated within the country to effect internal exchanges only. During the year 1923, the inflating internal currency (rouble) and the external money (Chervonetz) circulated in Russia concurrently with a constantly changing ratio between them.(1)

All the other countries of Europe, one after the other, stabilized their currencies in terms of the dollar. As the dollar was convertible into gold, the European currencies were linked to gold and with the stabilization of sterling in terms of gold, the International Gold Standard may be said to have been restored in 1925. In most xxxxxx cases, the currencies were stabilized at lower external values, and after stabilization they enjoyed some competitive export advantage due to internal undervaluation of their currencies and a little latitude for further inflation.(2) But in England, Denmark and Norway, where inflation did not go very far, the situation was exactly the reverse. As regards these currencies, exchange speculators were of opinion that they xxxxxxx had the ability

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(1) "Money", by D.H.Robertson, London, 1948. p.127.

(2) Ibid. pp.129 and 130.

and intention of restoring their old parities and they anticipated this by putting external values to these currencies higher than their internal values. When these currencies were stablized at these speculatively high external values, they became internally overvalued[1] and suffered from a competitive export disadvantage. This led to deflation and depression in these countries and there was a net diminution in their effective demand. Though the restoration of the gold standard did not lead to any global shrinkage of overall effective demand (because further increase of effective demand in countries which had stabilized their currencies with internal under-valuation more than offset the shrinkage of effective demand in countries with internally over-valued currencies), England, Denmark and Norway suffered a relative shrinkage in their money supplies and effective demand.[2]

Thus the restoration of the gold standard did not, in general, involve any immediate global shrinkage of prices or deflationary tendencies. Even after the restoration, rising prices continued for some years more[3] and the world market continued to be a sellers' market, in which of course the few countries with over-valued currencies could not participate fully. Considered from a global point of view, effective demand continued to be greater than the overall productive activity, and the observance of the gold standard rules did not clash

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(1) "Money", by D.H. Robertson, London ,1948 , pp.129-131.
(2) Ibid.
(3) Ibid.

with the new objective of maintaining internal economic stability for the time being (except again in the cases of the few countries with over-valued currencies). The monetary policies of the countries under the gold standard could thus maintain, for the time being, both internal and external stability but were always subject to the potential danger of a clash between the two objectives if the basic monetary condition did change, that is, if the global effective demand tended to fall below the level of global productivity.

SECTION 4. Currency Management in India from 1919 to 1925 and the Restoration of the Gold Standard.

India emerged out of World War I with a record of continuous favourable balances and a sterling accumulation of £240 million to her credit (though she still had a sterling debt). Although she was a belligerent country, her productive equipment did not suffer any physical damage as did that of her European Allies rather, her industrial productive power increased quite appreciably. Probably due to these reasons, India felt herself financially strong enough to make a bid for the restoration of the gold standard immediately after the war. India was second to America in making this effort. On the 30th May, 1919, the Babington Smith Committee was appointed to commend the best means to restore the gold standard in India. After recording its opinion that the stability of exchange rate in terms of gold was particularly important in a currency system like that of India, the Babington Smith Committee recommended that the gold standard be introduced forthwith in India, at the rate of 2s.0d. gold to the rupee. The rupee was to remain unlimited

legal tender and it was to have a fixed exchange value in terms of gold at the rate of one rupee for 11.30016 grains of fine gold, that is, one-tenth of the gold contents of the sovereign.(1) This high rate for the rupee was recommended because the Indian currency system was in potential danger from a further rise in the price of silver and a high rate kept the danger at a distance.(2) The India Government accepted the recommendations of the committee and stabilized the rupee at 2s.0d. gold.

This was an unwarranted decision for India to take for more reasons than one. U.S.A. was at that time the only important country on the gold standard. The restoration of the gold standard by India, therefore, necessarily involved fluctuating Indian exchanges with all other countries except U.S.A. It is not to be denied that U.S.A. transformed herself into a major economy in the course of the war. Her import market was second only to that of Great Britain and she emerged out of the war as the premier creditor country of the world.(3) Great Britain was no longer the only major ecohomy as she had been before the war; at the close of the war, she had to share this honour with U.S.A. But despite this transformation, stable exchange rate with U.S.A. was not more important to India than with Great Britain for the simple reason that India even then had the major part of her trade and financial transactions with Great Britain. The stability of sterling rate

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(1) "Babington Smith Committee Report 1919". para.59.

(2) Ibid. paras. 43 and 57-60.

(3) "Prosperity Decade: A Chapter from American Economic History 1917-1929", by G. Soule, New York, 1947. p.254.

was, therefore, more important to her than that of the dollar rate.[1] Moreover, India emerged from the war with a big sterling reserve while she had no dollar reserve at all and her gold reserve was a small fraction of her sterling holding. It was, therefore, much easier to maintain the sterling rate rather than the gold or dollar rate and there was no raison d'être for India to subscribe to the gold standard before Great Britain did so.

But the more important argument against the adoption of the gold standard was the imminently difficult balance of payments situation which should have been foreseen. The sterling rate of the rupee then prevailing was an arbitrary loan rate of the war period which was moved up to that high level by an abnormal rise in the value of silver. It had no connection with the trade situation between India and Great Britain. From 1914 to 1920, price-level in India nearly doubled while in the U.K., it nearly trebled.[2] These relative price movements might have justified an improvement in the sterling rate of the rupee by 50%, but the actual improvement was by 150%. It should, therefore, have become obvious that once normal trade was resumed, the artificially high exchange rate was sure to suffer an appreciable diminution.

After the announcement of the Government decision to stabilize the rupee at 2s.0d. gold, there was a further initial speculative rise in the rupee exchange which stood at the un-

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(1) "Indian Economics", by G.B.Jather and S.G.Beri", Bombay, 1945. Vol.II. pp.219 and 220.

(2) Indian price level: Calcutta Index, Base: 1914 = 100.
British price level: Board of Trade Index, Base: 1913=100.

precedented figure of 2s.10½d. on the 11th February, 1920; then, however, a reaction set in for various reasons. The termination of the war automatically brought to an end the abnormal war demand for Indian exports. Despite their high and rising prices, the devastated countries of Europe were unable to bid for Indian exports because of their extreme dearth of foreign exchange as well as of gold. Moreover, the failure of the rains in India in 1920 and prohibitively high prices of foodstuffs, forced the government to put an embargo on export of food crops. Japan had a serious crisis in the same year and could not take her normal quota of cotton from India. All these causes led to a sharp shrinkage of Indian exports. On the other hand, strong forces were in operation to increase imports in India. During the war, Indian manufacturing industries could not be technically improved and reorganized because of the shortage of machines and plants, which were all of foreign make and could not be imported. Moreover, there was an accumulated delayed demand for consumption goods and just after the war, huge quantities of machinery and manufactured consumer goods were imported. The high exchange also helped these purchases very considerably as their rupee prices fell very low. Due to the operation of these combined forces, the balance of trade turned strongly against India,[1] as will be clear from the table on the following page.

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(1) "India's Foreign Trade since 1870", by P.Roy, London, 1934. pp.111-115.

Balance of Foreign Trade of India in Merchandise.[1]

(In crores of rupees)

Year	Import	Export	Balance
1919-20	221.70	336.02	+ 114.32
1920-21	347.56	267.76	- 79.80
1921-22	282.59	248.65	- 33.94
1922-23	246.19	316.07	+ 69.88
1923-24	237.18	363.37	+ 126.19

The unfavourable trade balance brought about a severe pressure on the exchange rate and this was further aggravated by the upward trend of the value of gold. There was a sharp decline in the production of gold in 1920 when it was 333 million (U.S.) gold dollars in place of 358 million (U.S.) gold dollars in 1919. This decline in gold production continued up to 1922.[2] On the other hand, a rush to seize gold by the different countries for monetary reserves followed about the same time and added to the increased demand for gold. Due to these causes, there was a sharp rise in the value of gold.

The unfavourable trade balance and the rising price of gold not only led to the disappearance of the demand for Council Bills but to a strong demand for Reverse Councils. These put a double strain on the Secretary of State's gold resources - to meet Home Charges as well as to support the exchange rate. The Government at first started to sell Reverse Councils at rates based on 2s.8d. sterling on February 5th, 1920. The rate was raised to 2s.10$\frac{27}{32}$d. on February 12th, but

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(1) "Review of the Trade of India 1929-30." p.8.

(2) "International Currency Experience", League of Nations, 1944. p.233.

thereafter it decreased as sterling appreciated.[1] The Reverse Councils were paid in London out of the proceeds from the sale of sterling securities and Treasury Bills belonging to the Paper Currency Reserve. Intense demand for, and sale of, Reverse Councils reduced the Secretary of State's gold reserve to a dangerously low figure. By the end of June, the balance of trade began to turn strongly against India, with the result that despite the heavy sale of Reverse Councils, the market rate of exchange not only departed from the parity of gold, but also fell below the parity of 2s.0d. sterling. It was apparent that even if the sale of Reverse Councils was increased so that the entire gold reserves of India were exhausted, it was not possible to stop the downward trend of the exchange rate. The Government admitted the inevitable and tried to maintain the rate at 2s.0d. sterling from June 24th, 1920.[2]

But this decision to stabilise the rupee at 2s.0d. sterling was taken very late and was too inopportune under the circumstances.[3] Great Britain was following a policy of severe deflation at this time to restore sterling to the pre-war gold parity. Stabilization of the rupee at any sterling rate would have involved a severe deflation of Indian currency over and above the basic deflation required to correct the wartime rise of the Indian exchange rate. Moreover, adhering to sterling necessitated a greater degree of deflation of the Indian currency because sterling was rising in value in terms of gold due

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(1) "Hilton Young Commission Report 1926". para.8.

(2) Ibid. para.8.

(3). Ibid. para.8.

to the deflationary policy of Great Britain. The Government was, therefore, required to possess a much bigger sterling reserve to maintain a sterling rate. India had indeed possessed a big sterling reserve of £240 million during the war which could have served her in good stead in this connection, but she had already made a free gift of this amount to His Majesty the King. India was thus no more able to maintain the sterling rate than the gold rate. Despite the government's efforts to the contrary, the market rate of exchange continued to fall. The Indian Government was compelled to reduce its own rupee-rate "following the market rate and the only principle that was adopted was to keep the official rate at a somewhat higher level than the market rate."(1) But this also could not continue indefinitely and by the end of September, the Government withdrew from the exchange market altogether, after selling from the beginning of the year, Reverse Councils to the extent of £55,382,000.

After the withdrawal of the Government from the exchange market, the exchange rate continued to fall as rapidly as before and early in 1921 fell below the low level of 1s.3d. sterling and 1s.0d. gold. In 1922-23, the export trade of India showed a revival due to an improvement in the purchasing capacity of the European countries. The joint result of the contraction of currency and the revival of export was a rise in the exchange value of the rupee at a slow but steady rate.(2) In September 1923, the rupee was equivalent to about 1s.3 1/8d.

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(1) "Indian Economics", by G.B.Jather and S.G.Beri, Bombay, 1945, Vol.II. p.280.

(2) Ibid. p.283.

gold. From December 1922 to June, 1924, that is, for eighteen months, the gold-exchange-value of the rupee remained fairly stable at about 1s.3d. gold. During the same period the rupee price-level remained fairly stable at approximately 176 (the limits being 170 and 181).(1) The genuine exchange rate was apparently attained at that level.

Extraneous factors again began to disturb the exchange rate thereafter. In June 1924, the pound sterling stood at 88.8% of the pre-war gold parity. Having decided to raise the dollar sterling rate to the pre-war gold parity, Great Britain resorted to a serious deflation. In consequence, the sterling-price-index fell from 163 in June 1924, to 149 in February 1926, that is, a fall of about 9%.(2) The Indian Government effected a greater degree of deflation, not only to maintain the sterling rate, but to raise it further. The sale of Council Bills was kept suspended and the Secretary of State met the Home Charges from the gold reserves. The Indian price index number fell from 176 to 157 (Calcutta index) that is, by 11% and the rate of exchange rose from 1s.4d. to 1s.6d. gold, that is, by 12½%.(3) Although for the maintenance of the sterling rate, a measure of deflation in India was necessary, there was no definite reason why this deflation should have been carried to excess and another dislocation in trade with Great Britain caused.

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(1) "Hilton Young Commission Report 1926". para. 182.

Calcutta index: Base, 1913 = 100.

(2) "Economic Problems of Modern India", by R.R.Mukherjee and H.L.Dey, London, 1941. Vol.II. p.277.

(3) Ibid.

The exchange value of the rupee reached 1s.6d. gold in April 1925 and from that time the Indian currency system was linked to the International Gold Standard, with a part of her money supply and effective demand guillotined by a measure of deflation. But this deflationary measure did not seem to have inconvenienced her export trade, at least for the time being, as there was a tendency for the Indian exchange rate to rise above 1s.6d.gold. The Government's action after April 1925 "was directed towards preventing the rise of the rupee much beyond this point."(1)

Thus, from 1920 to 1925, the role of Indian monetary management either in maintaining balance of payments equilibrium and a high level of international trade, or in stimulating internal productive activity may be regarded as entirely passive or even negative. India's attempts in 1920 to establish a gold ratio and then a stable sterling ratio, failed ignominously and she left the balance of payments equilibrium to take care of itself. Although after 1920, she allowed the exchange rate to fluctuate freely, that policy was not motivated by consideration for internal stability. All these years, she followed a policy of deflation,(2) and in 1920 and 1924 to such extents that prices suffered sharp declines as will appear from the table on page 140 of this thesis.

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(1) "Indian Economics", by G.B.Jather and S.G.Beri, Bombay, 1945. Vol.II. P.283.

(2) Ibid.

(1)

Index Numbers of Wholesale Prices in India.

(Calcutta Index 1914 - 100.)

Year	Price indices
1920	201
1921	178
1922	176
1923	172
1924	173
1925	159

Although the internal monetary policy of India was thus mainly negative in character, external factors were highly favourable to her attaining a high level of international trade as well as ~~to~~ stimulating international productive activity. U.S.A. was having a prosperity boom from the end of 1921 and was purchasing more raw materials from the rest of the world. There was, moreover, a pronounced global increase of manufacturing production from 1921 increasing the demand for raw materials of which India was one of the suppliers to the world market. Last, but not least, Great Britain, the major economy which constituted the bulk of India's market, was participating fully in the general increase of manufacturing activity. Due to this combined demand for Indian exports, the quantum of India's foreign trade increased continuously during these years and brought prosperity to the Indian farmers. The latter constituted the main market of the Indian manufacturing products and their prosperity stimulated the manufacturing production of India very definitely. All these developments of these years have been put in tabular form on the next page.~~xxxxxxxxxxxxx~~.

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(1) "Review of the Trade of India 1927-28" and "The Report of the Controller of Currency 1927-28", Statement I.

	1921	1922	1923	1924	1925
Indices of Manufacturing Production, base 1913.(1)					
World	81.1	99.5	104.5	111	120.7
U.S.A	98	125.8	141.4	133.2	148
U.K.	74.7	81.8	55.4	81.8	94.9
Quantum of India's Trade, base 1913-1914. (2)					
Export	127	140	145	154	152
Import	214	169	190	180	158
Index of India's Manufacturing Production	112.6	116.5	116.5	133.0	132

Thus the international sellers' market helped India to have a rising quantum of international trade as well as an increasing productive activity, particularly in manufactures.

Section 5: International Monetary Management from 1925 to 1929: Conflict between the two aims of Monetary Policy.

Monetary policy, intended both to stimulate internal productive activity and to attain a high level of international trade by observing the gold standard rules, at first worked fairly well after 1925. The basis of this policy had been founded in U.S.A. three years before the International Gold Standard was restored. After a short post-war slump, a recovery boom, without any outside help, began in U.S.A. from the end of 1921 and from the very beginning she began to extend loans to European countries to enable them to purchase her goods. With the international monetary equilibrium restored under the gold standard in 1924-25, confidence in the international capital market revived and

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(1) "Industrialization and Foreign Trade", League of Nations, 1945. pp.134 and 135.

(2) "Review of the Trade of India, 1929-30". p.9.
Indian figures relate to 1921-22, 1922-23, 1923-24, 1924-25 and 1925-26.

American capitalists began to extend huge amounts of both long and short-term loans to Germany and other European countries. The latter had, of course, to pay interest and amortization of these loans as well as of previous inter-governmental debts in addition to reparations to U.S.A. But U.S.A. re-lent to Europe much more than she received on these accounts, resulting in a net export from America to Europe. This net export supplied an additional stimulus to the American expansionary programme which was already materializing.(1) Thus, internal expansion and the expansion of international trade supplemented each other. The industrial production (in which the most significant item was the automobile industry) recorded a phenomenal increase. The index of production rose from 98 in 1921 to 148 in 1929.(2) The national income recorded an equally phenomenal increase; rising from $59.4 billion in 1921 to $87.2 billion in 1929.(3) If allowance is made for price changes, per capita income is found to have risen from $522 in 1921 to $716 in 1929.(4)

Increase in the productive activity and national income increased the demand of America for foreign goods, the imports of which were very much facilitated after the general restoration of the gold standard. In 1927 and 1928 America consumed 39% of the total consumption of nine of the most important foodstuffs and raw materials consumed by the fifteen most important industrial countries of the world.(5) In 1929 she purchased

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(1) "Prosperity Decade: A Chapter in American Economic History 1917-1929", New York, 1947. p.264.
(2) "Industrialization and Foreign Trade", League of Nations, 1945, p.134, Base: 1913 = 100.
(3) "Prosperity Decade: A Chapter in American Economic History 1917-1929", New York, 1947, p. 108.
(4) Ibid. p. 108. At 1929 Prices.
(5) Ibid. p. 266.

12.2% of the total imports of the world and was only second to Great Britain as an import market.(1)

The continuous increase of American imports and a net flow of American loans supplied an expansionary urge on the economies of other countries. American loans made up the capital shortage from which Germany was suffering after the devastations of the war and helped to rebuild her productive organization for four years from 1924. During these four years of borrowing both production and foreign trade increased continuously. In 1928 German production rose 30% higher than the level of 1925.(2) Foreign borrowing helped the payment of reparations not by meeting these directly but by increasing the volume of production and national income of the country which increased the revenues of the government and provided sufficient foreign exchange for the purpose.(3) Foreign trade also recorded a remarkable increase. While in 1925, imports amounted to 77.4 of their 1913 value, in 1928 they amounted to 90% of their 1913 value. Exports increased from 58.3 in 1925 to 77.2 in 1928 on the basis of their value in 1913.(4) The other war devastated European countries also rehabilitated their productive organization with the help of American loans.

Much more important than the American loans was the American import market. The countries that immediately benefitted from the expansion of the American market - the Dutch East

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(1) "Prosperity Decade: A Chapter in American Economic History 1917-1929", New York, 1947. p.266.

(2) "The Ecohomic Lessons of the Nineteen-Thirties", by H.W.Arndt, London, 1944. p.27.

(3) Ibid. p.28.

(4) Ibid. p.27 and 28.

Indies, Malaya, India, Japan, Canada and Latin-America etc. - were those which supplied industrial raw materials and foodstuffs.[1] The increased incomes of these countries, derived from their increased sales to America, enabled them to purchase more finished products from Great Britain, France, Germany etc.; and the latter in turn, purchased more raw materials and foodstuffs from the agricultural countries. Through all these cross-connections, all the other countries of the world experienced the expansionary effect.

The American and world boom particularly benefitted France as she specialised in luxury goods and fashion products as well as in invisible exports in the form of a tourist traffic and the world demand for all these increased immensely by general prosperity. The foreign trade of France hit the record target in 1928 and 1929. In four years, her export trade increased by 14%.[2] Her export trade was particularly helped by a considerable undervaluation of the franc and this gave her a competitive exchange advantage over the dollar, the pound and the mark.[3]

Great Britain was suffering during all these years a serious competitive disadvantage with her overvalued pound. Moreover, the technological developments of the 20th century affected very unfavourably some of her principal export industries.[4] The coal industry faced increasing competition from hy-

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(1) "Prosperity Decade: A Chapter from American Economic History 1917-1929", by G.Soule, New York, 1947. p.266.

(2) "The Economic Lessons of the 1930's", by H.W.Arndt, London, 1944. p.24.

(3) Ibid.

(4) Ibid. p.20.

dro-electricity and oil, while the steel industry met increasing rivalry from lighter metals. The extremely cheap labour of Japan gave her a decided advantage over Great Britain - particularly in textiles.(1) High tariffs against some British products in many of her former markets crippled her corresponding industries.(2) During these four years, the percentage of her manufacturing exports (among the principal industrial countries of the world) shrank from 26% to 22%,(3) and she was encumbered with an unemployment problem averaging one-tenth of her labour population and numbering between 1 and 1.2 millions.(4) Nevertheless, Great Britain did not remain unaffected by the prosperity boom. From 1924 to 1929 her production increased by 12%.(5)

Taking a global view, the expansionary boom started by U.S.A. benefitted the world as a whole as well as most countries individually. The following table showing the indices of manufacturing production can be taken as representative of the expansion of economic activity of the period:-

Indices of Manufacturing Production.(6)

(1913 = 100)

	1921-25	1926-29
World.	103.2	138.9
U.S.A.	129.3	163.6
Germany.	77.7	112.2
France.	95.3	130.6
U.K.	76.4	92.6
India.	122.1	146.6

(1) "Economic Lessons of the 1930's", by H.W.Arndt, London, 1944. pp.2o and 21.
(2) Ibid.
(3) Ibid. p.20.
(4) Ibid.
(5) Ibid.
(6) "Industrialization and Foreign Trade", League of Nations, 1945. pp.180.

The expansion in productive activity was reflected in the expansion of international trade as well. The following table showing the quantum of international trade can be taken as representative of the general trade expansion:-

Indices of World Trade in Manufactured Articles.(1)

(Base: 1913 = 100)

	1921-25	1926-29
World.	76.6	104.3
U.S.A.	101.5	157.8
Germany.	64.8	87.6
France.	68.8	79
U.K.	68.9	97.4
India.(2)	61.3	95.3

Thus, during these four years, both productive activity and the international trade of the world as well as of most individual countries experienced a considerable expansion. The monetary policy of maintaining both internal and external economic stability seemed to have succeeded fairly well.

But during all these years a contradiction was developing between the two aspects of monetary policy, that is, between the maintenance of productive activity and observance of the gold standard rules for a high level of international trade. The maintenance of American productive activity depended mainly on the continuance of American effective demand and partly on the net export of America to the rest of the world. But both the factors were harbouring germs of impending decline. Consumers' income, the basis of effective demand, began to

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(1) "Industrialization and Foreign Trade", League of Nations, 1945. pp.157/162 and 163.

(2) Ibid. p.163. Refers to imports only.

suffer a sharp decline in U.S.A. from 1927.[1] The annual growth of total wages and salaries which in no previous year (except 1924) fell below $1.5 billion, and the average of which was much higher, sank to less than $400 million in 1927.[2] Payment of wages and salaries showed little gain in manufacturing, a fact which is striking because manufacturing output continued to increase. Wages and salaries declined actually in construction, trade and mining industries. Decline in consumers' income led to a shrinkage of consumer spending and tended to decline American investment and, therefore, American productive activity.[3] U.S.A., therefore, needed a much greater balance of net exports to make up the loss of decline in the domestic demand. But further increase of net exports also became increasingly difficult.

The continuance of American net exports depended on a greater volume of American loan to European countries than the latter were required to pay to America in the form of amortization and interest charges on the previous loans. Further expansion of American loans depended on further expansion of investment facilities in Europe. But the sources of profitable investment in Germany and other European countries were being rapidly exhausted and the scope of further American loans was being diminished rather than expanded.[4] The equilibrium in the balance of payments had, therefore, to be main-

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(1) "Prosperity Decade: A Chapter from American Economic History 1917-1929", by G.Soule. New York, 1947. p.276.

(2) Ibid.

(3) Ibid. p.277.

(4) Ibid. p.273.

tained by an ever increasing export of gold from Europe to America.(1) According to the rules of the gold standard game, a continuous import of gold from Europe to America should have been expected to raise the American price level at a multiple rate. The rise of American prices by discouraging imports and encouraging exports would have restored the external equilibrium again. But that would have meant not only the increase of American prices but also the diminution of employment in American export industries and would have disturbed her internal economic stability. The external stability could have been maintained only at the cost of internal stability but this, America was not willing to countenance.

For the time being U.S.A. avoided the choice between the internal and external stability of money by adopting a very novel policy. She neutralised the excess supply of gold without sacrificing the convertibility of her currency into gold. This she did by simply replacing the notes that required 40% reserves, with the other type of her common money which required 100% reserves. It was tantamount to neutralising the price-raising effect of 60% of the gold reserves.(2) To avoid the divergence between the value of gold and the dollar, America did not adopt the English method of controlling her currency and adjusting the value of her currency to the value of gold, but she adjusted the value of gold to the value of her currency by substituting one common money for another

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(1) "Prosperity Decade: A Chapter from American Economic History 1917-1929", by G.Soule, New York, 1947. pp.270 and 271.

(2) "Money", by D.H.Robertson, London, 1948. pp.79-81.

or by altering the reserve proportion. By thus locking more and more gold in her gold certificates requiring 100% reserves, U.S.A. simultaneously maintained the stability of the value of the dollar and the stable relation between the dollar and gold.(1) Thus "it is arguable that a truer impression of the state of the world's monetary affairs would be given by saying that America (during this period) was on an arbitrary standard while the rest of the world climbed back painfully on to a dollar standard".(2)

But U.S.A. could not possibly have expected to maintain the currency equilibrium indefinitely by a gold-neutralisation policy for the simple reason that the amount of gold which Europe could export was not inexhaustible. Time was drawing near when the scarcity of exportable gold would have dis-rupted the currency equilibrium and throttled trade between Europe and America. By this policy, U.S.A. simply postponed the decision between internal and external stability but could not solve it.

France also played a game of gold neutralisation during these years. The considerable undervaluation of the franc helped her to have a surplus balance of payments and she received continuous imports of gold. She accumulated a very big gold reserve which was second only to that of U.S.A. The bulk of this gold was sterilised and was not allowed to exert its full influence on the price-level and thereby disturb the internal economic stability of the country. For this reason

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(1) "Money", by D.H.Robertson, London, 1948, pp.79-81.

(2) Ibid. p.81.

the advantage of competitive exchange depreciation persisted and was draining away the gold reserves of other countries. The reserves of Great Britain were particularly hard hit.

While U.S.A. and France were neutralising their gold imports for maintaining their internal economic stability deliberately, Great Britain was faced with the opposite difficulty of an unfavourable balance of payments, and her inability to lower prices and costs to increase exports and restore the external equilibrium of the country. The substantial overvaluation of the pound was mainly responsible for the unfavourable balance which could be corrected by lowering the cost of production of British exports involving lowering of British wage rates. But wage-rates proved absolutely intractable to any downward move.(1) Any attempt in that direction only led to political strife. Thus, high costs and restricted export trade, were causing an accumulation of unfavourable balance and draining away of British gold reserves.(2) Again, British depressed industries such as coal, cotton, woollen, worsted, iron and steel and ship-building had their world demand seriously restricted and a considerable proportion of labour and capital locked in these industries had to be transferred to the growing industries of the south to restore her competitive position in the world market. But labour and capital were found to be greatly immobile.(3) The capitalists would suffer losses and labourers unemployment and reduction of wages rather

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(1) "The Economic Lessons of the 1930's", by H.W.Arndt, London, 1944. pp.20 and 21.

(2) Ibid.

(3) Ibid. pp.276 and 277.

than shift to other employments. To what extent the immobility of labour and capital and the inflexibility of wages were motivated by the new ideal of internal economic stability cannot be ascertained, but at the same time the influence of the latter on the former cannot be altogether denied. These frictional maladjustments constantly deteriorated the external equilibrium and were destined to disrupt the gold standard and throttle international trade sooner or later.

Thus, in U.S.A., Germany, France and U.K., that is, in all the major economies of the world, a clash between the two monetary objectives was in progress and rapidly coming to a head. For their internal economic stability, each of these major economies was maintaining a precarious balance by manipulating their gold reserves, that is, by sterilising or losing gold. But as this gold jugglery was approaching its end, each of these coutries was destined to be confronted with the problem of choosing either external or internal stability as the guiding principle of their monetary management.

Section 6: Indian Monetary Management from 1926 to 1929.

Monetary management in India from 1925 consisted of the observance of the gold standard rules. The Government of India in response to repeated requests from various quarters promised an enquiry into the currency situation early that year and on August 25th, 1925, a Royal Commission on Indian Currency and Exchange was appointed with Lt.-Commander Hilton Young as president. The report of the Commission was published on August 4th, 1926 and it recommended a gold bullion stand-

ard for India. The rupee was to be stabilized in relation to gold at a rate of 1s.6d. and having the value of 8.47 grains of gold. The Currency Act of 1927, legalised this gold ratio of the rupee on which it remained up to 1931.(1) During these years, India maintained her balance of payments equilibrium strictly according to gold standard rules.

India, however, did not remain completely unaffected by the new trend of thought that advocated monetary management to be so conducted as to stimulate domestic economic activity. She was influenced by this idea to such an extent that in 1927 a bill was brought before the Indian Legislature to establish a Central Bank for India, - an instrument accepted by the economic opinion of the time to be capable of adopting monetary policies to simulate and stabilize the economic activity of the country concerned. But the Central Bank Bill of India gave rise to a very bitter controversy because the nationalist leaders feared that the proposed Central Bank would be controlled by the European business community to the detriment of Indian interests and to forestall this, they wanted it to be a state-owned bank. This militated so much against the prevailing idea of a private Central Bank that the Government was constrained to withdraw the Bill in 1928. Due to the absence of a Central Bank, Indian monetary management could not be conducted to maintain internal economic stability but had to be restricted to the maintenance of the external stability of the rupee only.

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(1) "The Economic Development of India", by V.Anstey, London, 1946. p.428.

Although India was observing gold standard rules to attain a high level of international trade yet the external factors were anything but favourable to attain this end. In the first place, Great Britain which constituted the principal market for Indian exports, was semi-depressed (at least far from being prosperous) during these years and naturally could not take the normal quota of Indian exports. Secondly, it is no doubt true that a sellers' market continued during these years but that was only as regards manufacturing goods. Demand for agricultural goods which constituted the bulk of Indian exports was definitely on a down grade from 1926.(1)

The basic cause of this lay in a much greater global production of agricultural goods in relation to their demand, due to an overdevelopment of agricultural industry. During the war, European agriculture was completely disorganized, but this loss in agricultural production was very substantially mitigated by increased production in U.S.A., the British Dominions and some South American Republics who adopted the most scientific methods of agriculture. From 1922, European agriculture was rapidly rehabilitated, partly with the help of American loans, and the total world production soon outstripped its demand. To make things worse, the overdevelopment of the agricultural industry of U.S.A., instead of being curtailed, received further financial assistance from banks and government and agricultural investment and output steadily increased.(2)

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(1) "Prosperity Decade: A Chapter from American Economic History 1917-1929", by G.Soule, New York, 1947. pp.229-249.

(2) Ibid. p.125.

The agricultural countries with a surplus productive capacity as well as a surplus produce began to maintain a precarious balance by a continued accumulation of stocks. But this could not arrest the fall of agricultural prices which set in from 1926, and very adversely affected Indian exports. The American bumper crop of 1928 brought things to a head and set afoot an agricultural depression. Partly due to the half-depressed British economy, but mainly because of depression in world agriculture, the quantum of Indian foreign trade continuously declined during these years.

(1)

Quantum of Indian Foreign Trade.

(Base 1913-14: = 100)

Year	Export	Import
1925-26	152	158
1926-27	132	148
1927-28	130	136
1928-29	127	133
1929-30	118	128

Decline in foreign trade and particularly of exports diminished the income of the Indian farmers and made them poor purchasers of manufactured goods. This in turn reacted unfavourably on the manufacturing activity in India which made very little headway during these years; there were also years of recession.

(2)

Annual Indices of Manufacturing Production in India.

(Base 1913: = 100)

Year	Index
1926	144.7
1927	151.5
1928	133.0
1929	157.3
1930	144.7

(1) "Review of the Trade of India, 1929-30". p.9.

(2) "Industrialization and Foreign Trade", League of Nations, 1945. p.135.

During 1921-25, the part that India herself played in her currency management was completely passive, if not negative, but due to the favourable external circumstances she enjoyed both a rising grade of international trade as well as international productive activity. But during 1926-29, India herself maintained a stable international currency relation, but external factors were definitely unfavourable to her. Both her international trade and productive activity was definitely on a downward grade during the later years. This difference between the two periods, definitely indicated the greater importance of external factors in attaining India's monetary objectives than her own part in attaining the same end.

Section 7: The American Crisis of 1929, the Great Depression and the Liquidation of the Gold Standard in 1931.

The internal economic stability, for which the gold standard rules were so seriously strained in many countries, could not, however, be adequately assured anywhere, and particularly in U.S.A. The American prosperity boom, which started from 1922 under the favourable circumstances of the sellers' market of the world, was all the time developing a disproportionality consisting of overdevelopment of capital goods industries out of all proportion to consumption goods industries. Investment in capital goods between 1919 and 1928 increased at the rate of 6.4% while that of consumption goods only at the rate of 2.8%.[1] Moreover, a decline in consumption expenditure set in

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(1) "Economic Lessons of the 1930's," by H.W.Arndt, London, 1944. p.16.

from 1927.[1] Consumption expenditure was the basis of demands for capital goods and the motive force for capital investments. Disproportionate capital investment in face of declining consumption expenditure was an absurd development and was bound to disorganize internal productive activity. The American monetary authority could not regulate investment, least of all, could it regulate capital investment.[2] What it could do was to adopt a dear money or cheap money policy. But entrepreneurs were found to undertake investment with very little regard to interest rates and particularly the proportion of capital-industry to consumption-industry investment was found to be unconnected with interest rates.[3]

When the preposterous stock-speculation began in U.S.A. in 1928, it was proved that the power of the monetary authority to influence internal prices (and particularly stock prices) was practically nil. Dear money could not curb the activities of the speculators in the least.[4] In the face of a declining consumer-spending and decreasing employment in many lines,[5] the increase of stock prices by the activities of the speculators was really an absurd development and could not last long. From the 24th October, 1929 the bubble of speculation was pricked and Wall Street began to suffer one crash after another.[6] The collapse of the stock speculation

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(1) "Prosperity Decade: A Chapter from American Economic History 1917-1929", by G.Soule, New York, 1947. p.276.

(2) Ibid. p.272.

(3) Ibid. p.276-279.

(4) Ibid. p.272.

(5) Ibid. pp.281-288.

(6) Ibid. pp.306-313.

caused the most precipitous fall in security prices and immense losses in individual capital. It had the most depressing repercussions on the investors who not only stopped further investments but also tried dis-investments. The monetary authority could not persuade them to undertake investment under any conditions of cheap money.(1) Unemployment began to mount by millions and there was a most disastrous decline in income and consequent shrinkage of consumption spending.(2) Even those who were left with sufficient income became scared and reduced their expenditure. There developed a veritable liquidity mania. Every American became a seller and tried to sell anything he could get hold of. American capitalists summarily recalled their short-term foreign loans and suspended their long-term lending. The American market became overstocked with saleable goods but no American was inclined to buy anything and the import market completely collapsed.

In the post-war years, the effective demand for goods of all kinds on a global basis was much ahead of the supply of goods and production. This situation was mainly a legacy of the war which created an inflation, on the one hand, and disorganized the world production, on the other. The post-war world market could be termed a sellers' market because sellers with their limited stocks could dictate their terms to the buyers who needed a much bigger supply. After the restoration of the gold standard in 1924-25, though considerable parts of this

(1) "Prosperity Decade: A Chapter from American Economic History 1917-1929, by G.Soule, New York, 1947. p.310.

(2) "The Economic Lessons of the 1930's", by H.W.Arndt, London, 1944. pp.31-33.

excessive effective demand in many countries were curtailed, yet the overall effective demand of the world did not diminish in the least. The sellers' market continued under the gold standard as well and maintained the profitability of investment and production for a few more years. Under the stimulus of this excess demand, world production proceeded apace (1) and nearly caught up with the global effective demand by 1928. By 1929, world production was probably slightly ahead of effective demand and in many sectors of production declining tendency of prices made its appearance. When at this juncture the American demand, which formed a considerable part of the world demand, completely collapsed, the global effective demand suffered a severe shrinkage. Supply of goods and their productive equipment thereafter became immensely greater than this attenuated world demand. (2) The world market became a buyers' market where buyers in view of their scarcity could dictate their terms.

The consequence of this collapse of world demand (or world market) was disastrous to employment, income and production in all countries. The crisis of 1929 and the Great Depression that followed was purely an internal affair of U.S.A. Her foreign trade did not exceed 6% of her total trade and her internal economy was not dependent on the foreign market. (3) But the rest of the world was very vulnerable to American depression because her imports constituted a substantial

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(1) "Industrialization and Foreign Trade", League of Nations, 1945. pp 134 and 135.
(2) " The Economic Lessons of the Nineteen Thirties", by H.W. Arndt, London, 1944. pp.31 and 32.
(3) " Prosperity Decade : A Chapter from American Economic History, 1917-1929, by G. Soule, New York, 1947. p. 265.

part of their exports. Decline of American consumption demand affected their export trade and through that, their internal economy very adversely.(1) From 1928-1932, production in Germany, for example, fell by 46%.(2) While between 1925 and 1929, unemployment in Germany ranged from one to two millions, it reached six millions in 1932.(3) State unemployment insurance did not allow the decline of consumers' demand in Great Britain below a certain level and for this reason decline in British economic activity was less severe than in U.S.A. or Germany. But even then it was sufficiently bad to record the lowest employment level for any time. About three millions of her workers were without employment.(4) Between 1929 and 1932, national income in U.S.A., Germany and Great Britain declined by 53%, 42% and 17% respectively while wholesale prices fell by 38%, 35% and 30% respectively.(5)

The decline in manufacturing production in comparison with the previous boom period reveals eloquently the devastation wrought by the Great Depression.(6)

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(1) "The Economic Lessons of the 1930's", by H.W.Arndt, London, 1944. pp.31 and 32.

(2) Ibid. p.30.

(3) Ibid.

(4) Ibid. p.22.

(5) Ibid.

(6) See tables on the following pages of this thesis.

(1)

Annual Indices of Manufacturing Production.

(Base: 1925-29 = 100)

Year	World	Germany	U.K.	France	U.S.A.
1929	113.3	107.9	109.9	112.0	112.7
1930	101.6	93.5	100.0	109.8	92.3
1931	90.5	78.3	90.3	96.2	75.8
1932	80.1	64.6	90.4	82.7	58.4

The fall in the quantum of global international trade followed the decline in the internal economic activity as will be clear from the following table:-

(2)

Quantum of World Trade in Manufactured Articles.

(Base: 1913 = 100)

Year	World	Germany	U.K.	France	U.S.A.
1926-29	104.3	86.1	97.4	79	157.8
1930	99.7	89.7	93.4	92.7	135.9
1931-35	75.5	66.2	61.3	63.4	86.6

Up to 1931, at least, all these countries were on the gold standard but that could not save their international trade from suffering a grievous shrinkage. Thus, it disproved the idea that the gold standard could always maintain a high level of international trade, rather, international trade was found to be correlated with internal economic activity, both rising and falling together and both dependent on the American import market. From this fact it could further be inferred that if the collapse of the American market could paralyse the world trade and productive activity, a similar crisis in Great Britain, with a more important world market, would more easily break down the system. Parallelism need not have stopped with

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(1) "Industrialisation and Foreign Trade", League of Nations, 1945. pp.140 and 141.

(2) Ibid. p.162. and 157.

Great Britain.[1] From 1924, Germany reconstructed her economy and developed her productive organization to such an extent that by 1929 her import market was not far behind that of U.S.A. Similarly, the French import market also was not far behind that of Germany. Of course, it was also plain that if the import markets of these four major countries continued undisturbed, industrial crisis in any other country, forming very insignificant parts of the world market, would not appreciably harm world trade and productive activity. Now, the part played by the gold standard in those years of depression, was to maintain the balance of payments equilibrium and to facilitate that ~~xxx~~ volume of international trade which was possible during a period of low level of productive activity. Without the gold standard the volume of international trade in the first depression years would have probably been lower still. But the gold standard could not claim to maintain a high level of international trade; what it could claim was to maintain a level of international trade commensurate with a given level of economic activity.

But within a few years of the depression consequent on the American crisis of 1929, the gold standard was unable to maintain any balance of payments equilibrium at all and failed to maintain even that low level of international trade which was commensurate with the existing low level of productive activity.[2] Germany was peculiarly dependent on the American market - particularly on the American capital market. She rebuilt her industrial organization with American capital - about

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(1) "The Economic Lessons of the 1930's", by H.W.Arndt, London, 1944. pp.283-295.

(2) Ibid.

one-half of which was short-term advances. The stock-speculation and then the depression in America made the capitalists recall their short-term loans from Germany.(1) The flow of long-term capital also began to decline, and in 1930 and 1931, withdrawal of short-term funds continued at a rapid pace. American loans provided Germany with foreign exchange to pay reparations and with their stoppage, reparation payments created a serious exchange problem. Genuine doubts were now entertained about the exchange value of the mark. Foreigners, as well as Germans, now began to transfer their funds from Germany to foreign countries. Similar difficulty in Austria caused the failure of the Vienna Credit Anstalt in May 1931 and thereby started the European financial crisis of that year,(2) The Brunning Government attempted tc adjust the German economy by a policy of deflation, but it failed completely due to the continuance of flight capital. In the circumstances, the government was compelled to adopt exchange control to maintain external equilibrium. But exchange control necessarily involved the abandonment of a free gold standard.(3)

Great Britain was affected by world depression through the decline of her exports by 30% and a simultaneous increase of imports. The surplus of merchandise imports increased from £386 million in 1930 to £408 million in 1931.(4) Adverse British balance of payments and the blocking of British short-

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(1) "The Economic Lessons of the 1930's", by H.W.Arndt, London, 1944. pp.283-295.

(2) Ibid. p.29.

(3) Ibid.

(4) Ibid. pp.22-23.

term loans in the banks of Austria and Germany led to a panic withdrawal of foreign deposits from London and this completely exhausted the gold reserves of the Bank of England. On September 21st, 1931, Great Britain was thus forced to suspend gold payments and with this suspension, the International Gold Standard ceased to exist. The gold standard was thus discredited not only for its inability to maintain a high level of international trade consistently, but to maintain any level of international trade in depression time. It was unable to maintain its own existence during the depression and was thus found to be only a fair-weather craft.(1)

Section 8: Indian Currency Management during the Great Depression from 1929-1931.

The outstanding characteristic of the Great Depression was an excessive fall in agricultural prices out of all proportion to the fall in manufacturing prices. Because of this, the worst hit countries during the depression were the primary producing areas which were brought to the verge of bankruptcy. Despite the existence of some manufacturing countries on modern lines, India was primarily an agricultural country and the exports of India consisted mainly of agricultural goods and raw materials. With the onset of the depression, she was confronted with a shrinking export market and a disastrous fall of agricultural prices.(2) The situation was aggravated by the inelastic nature of agricultural production in India. In India, the cultivator did not produce any smaller quantity of crops so

(1) "Monetary Theory", by G.N.Halm. Philadelphia, 1946. p.197.

(2) "Economic Problems of Modern India", by R.R.Mukerjee, London, 1939. Vol.I. p.328.

long as the price obtained was above his nominal cost of production in which his wage and profit were not included. Restriction of production would, in most cases, have meant monetary loss to the farmer because he would then have gone without any work. In India, therefore, production was virtually independent of the price obtained and practically the same area was cultivated bearing the same crops. The following table gives the area under crops in British India during the years 1928-29 to 1931-32.(1)

Area under Crops in British India.

(000 acres)

Year	Food Crops	Non-Food Crops	Total
1928-29	200,269	51,189	251,458
1929-30	200,218	49,839	250,057
1930-31	202,706	48,067	250,773
1931-32	205,014	46,547	251,471

In the case of non-food crops there was an appreciable fall in production which was more than compensated by an increase under food crops. As the acreage remained practically constant, so also did the yield per acre apart from seasonal factors, and export prices were falling lower and lower. In the case of jute at least, the fall in prices was such that it probably fell even below the nominal cost of production.(2)

The extent of the fall in the quantum of international trade and of the disastrous decline of the Indian export prices caused by the complete collapse of the international market for agricultural goods, can be estimated from the table overleaf.(3)

(1) "Department of Statistics: Government of India". "Economic Problems of Modern India", by R.R.Mukerjee, London, 1939. Vol.I. p.330.

(2) "Bengal Jute Enquiry Committee Report".

(3) "Review of the Trade of India 1936-37." p.28.

Year	Quantum of Export	Quantum of Import	Price level of Exports	Price level of Imports
1927-28	100	100	100	100
1928-29	106.1	105.2	97.5	96.4
1929-30	108	103.4	90.2	93.2
1930-31	96.6	82.5	71.5	80
1931-32	82.5	70.6	59.2	71.7
1932-33	74.9	81.4	55.3	65.2

Moreover, like all other agricultural countries, India suffered from a deterioration of the terms of trade because the prices of her exports fell more heavily than the prices of imports as is clear from the table above.

Though agricultural productivity of India, did not decline in quantity, it shrank in value quite considerably. The disastrous fall in the prices of agricultural goods made Indian farmers, who were the principal purchasers of Indian manufacturing goods, very poor buyers. This made the depression spread to Indian industrial production as well. The indices of manufacturing production of these years recorded not only a stagnation in place of the rapid development that was taking place, but also positive recession.

(1)

Annual Indices of Manufacturing Production in India.

(Base: 1925-29 = 100)

Year	Index
1929	109.5
1930	100.7
1931	108.1
1932	108.1

India was on the gold standard up to September 21st, 1931 but that did not help her in any way to maintain the level of her international trade. Moreover, due to the disastrous fall in the prices of exports the positive balance of trade of India continu-

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(1) "Industrialization and Foreign Trade", League of Nations, 1945. p.141.

ously fell from 1929, as will appear from the table below, and payments equilibrium had to be maintained by a constant loss of gold reserves.

balance (1)
Merchandise Trade of India.
(In crores of rupees)

Year	Import	Export	Balance
1929-30	249.71	318.99	+ 69.28
1930-31	173.06	226.55	+ 53.44
1931-32	130.04	161.20	+ 31.16
1932-33	135.02	136.07	+ 1.05

The favourable balance of trade was a normal and essential feature of Indian trade because she had to service her foreign loans and pay for invisible imports therewith. By 1931, the balance of payments situation deteriorated to such an extent that Indian gold reserves were nearly exhausted and suspension of gold payments were impending. Great Britain gave up the gold standard in September 1931 and allowed sterling to depreciate to the extent of 30%. To maintain the innumerable financial banking and trade relations with Great Britain undisturbed, India went off the gold standard simultaneously with her, but kept the existing exchange rate with sterling and thereby had 30% depreciation in terms of gold. Even if she had not de-linked her currency from gold in 1931, India would have been forced off the gold standard in the following year when her positive trade balance disappeared altogether(involving a heavy deficit balance of payments for servicing her foreign loans). In fact,the sterling connection held out the prospect of a better level of international trade for India than the gold link. But this meant only a minor difference. The fundamental course of

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(1) Indian Economics. Vol II by Jather & Beri. Bombay 1945.p.203

Indian foreign trade was determined by the intensity of depression in the world market. Her attachment to the gold standard did practically nothing to arrest the deterioration of her foreign trade situation caused by the collapse of the foreign demand which, in effect, meant the demand of the major economies. While the experience of Indian currency management during 1925 to 1929 showed that the external factors were more important in attaining India's monetary objective than her own monetary policy, the experience of 1929 to 1931 demonstrated that the external factors were all important in having for India a high level of international trade. India either attained or failed to attain the objectives of monetary policy according to the rise or fall in the fortunes of the major economies.

The Problem of the Standards of Indian Currency

Chapter IV.

Indian Currency Policy and Problems: The Autonomous Currencies of the Thirties. 1931-1939.

CHAPTER IV.

INDIAN CURRENCY POLICY AND PROBLEMS

The Autonomous Currencies of the Thirties.

1931 to 1939.

Section 1. The Aims of Monetary Management from 1931. Internal Economic Stability alone.

When the Great Depression was shattering the international gold standard system in one country after another, strenuous efforts were being made by international institutions and conferences to rehabilitate the international monetary and trading system. But all those attempts failed without exception. The fundamental reason for these failures lay in the fact that after the onset of the depression, many countries did not accept the basic premise that the ideal was the restoration of the gold standard - the medium through which depression and unemployment originating in one country afflicted another.(1) With U.S.A. in the throes of a great depression, other countries were having serious deficit balance of payments and the observance of the gold standard rules by the latter necessarily involved the adoption of a policy of deflation with consequent depression in their internal economy. Moreover attempts to decrease imports to restore balance of payments equilibrium, automatically led to the curtailment of international trade. The gold standard stood for a high level of international trade but it was found that during the depression the

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(1)" The Economic Lessons of the Nineteen-Thirties", by H.W. Arnot, London, 1944. pp. 234-242.

very observance of the gold standard rules led to the restriction of foreign trade. For the continuance of international trade in those years gold standard was an obstacle rather than a help.

Again , it became almost obvious that even with their best efforts to observe gold standard rules, it was not possible for countries other than U.S.A. to maintain the international gold standard in operation for any length of time. With the collapse of American effective demand (or market) which constituted a significant part of the world's effective demand (or market), the latter fell short of the global productive activity and it was not possible to maintain currency equilibrium,and therefore gold standard,without compensating the deficient effective demand of U.S.A. As the rest of the world could not possibly increase its effective demand to make up the loss in American demand, the continuance of the gold standard was found to be dependent on the American effective demand at a high level. The same reasoning also indicated that the international gold standard depended for its pperation on the maintenance, at a high level, of the effective demand of Great Britain constituting a greaterimport market than U.S.A. It was not unlikely that the collapse of even German and French effective demand could have disrupted the gold standard. The maintenance of their normal quota of effective demand by each of the four major economies being the condition precedent for the existence of the gold standard and none of them being sure that others would be able to maintain their demand consistently, most of them were no longer inclined to subscribe to the international

monetary system and make their internal economies dependent on the uncertain markets of others. Instead, most of the major economies adopted monetary policies to stimulate their effective demand and provide their own markets on autarchic lines.

The Great Depression also revolutionised prevailing ideas about the most efficacious methods of maintaining effective demand and thereby internal economic activity. In the twenties it was generally presumed that the monetary authorities by simply adopting a dear or cheap money policy could regulate the volume of money and effective demand in their respective economies. But the monetary authority of U.S.A. was found to be completely unable to check the boom of 1929 with a dear money policy.(1) After the onset of the depression when the global effective demand fell below the prevailing economic activity of the world, a cheap money policy could not stimulate effective demand in U.S.A. in the least.(2) Entrepreneurs were not willing to take loans, undertake investment and thereby to stimulate effective demand at any low rate of interest. It was thus apparent that for stimulating effective demand what was needed was not only the regulation of the supply of money with an easy money policy but also the regulation of demand for money by adopting a compensatory investment policy either undertaken by the government or the monetary authority itself.(3) During the first half of the thirties, most of

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(1) "Prosperity Decade : A chapter from American Economic History 1917 -1929", by G. Soule; New York, 1947. p. 304.
(2) " Ibid p. 310.
(3) " Monetary Theory", by G.N. Halm, Philadelphia, 1946. pp.417-433.

the major economies adopted an anticyclical policy for stimulating their effective demand (and thereby to maintain their economic activity) by regulating both the supply of and demand for money.

On the supply side, the cheap money policy was the main device adopted by all these countries irrespective of their reserve position to stimulate entrepreneurs to undertake investments and thereby to increase the effective demand of the employees. On the demand side, attempts were made to increase the purchasing power of consumers, either by direct distribution of relief among the distressed or by direct undertaking of investment by the Government which increased the income of the employees and thereby increased their effective demand.(1) All these measures were adopted by each of the major economies that followed a recovery policy, but each country laid emphasis on a different measure. In Great Britain emphasis was on cheap money policy, in U.S.A. on relief measures and in Germany on public investments alone.

Section 2. The Recovery Measures of the Major Economies, 1931- 37.

Great Britain.

Although private investment in Great Britain was stimulated chiefly by a cheap money policy yet it received two other stimulants, one increasing directly the profitability of investment, the other increasing the private consumption expenditure. As Great Britain did not fully share the prosperity boom of the 1920's, many profitable

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(1) " The Economic Lessons of the Nineteen Thirties" by H.W. Arndt, London, 1944. pp.62, 122, and 156.

sources of investment were left unused, and these were undertaken after 1932.(1) The motor-car, electrical, rayon and other industries came into this class, but the most outstanding of this class was residential building which continued throughout the 1930's and accounted for about one-third of the increased employment of this period.(2)

The second support to private investment in Great Britain during this period came from the exceptional fall in the world prices of foodstuffs and raw materials. Great Britain, being an exporter of manufactures and importer of foodstuffs and raw materials, had her terms of trade improved to such an extent that a representative unit of her exports purchased 20% more imports than it did before the depression.(3) This low price of imports saved about £250 million of consumers' income which could, therefore, be spent on houses, motor-cars etc., and thereby stimulate the corresponding industries.(4)

Under the stimulus of these joint forces, private investment in Great Britain increased considerably and attained a remarkable degree of recovery from depression. The various indices of her economic activity in 1937 were higher than those in 1929. Excluding agricultural workers, the number of the employed rose from 10.2 millions in 1929 to 11.5 millions in 1937.(5) The index of manufacturing

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(1) "The Economic Lessons of the Nineteen Thirties" by H. W. Arndt, London, 1944 pp. 122, 125, and 166.

(2) Ibid

(3) Ibid p. 131

(4) Ibid p. 131

(5) Ibid p. 127

production rose from 109.9 in 1929 (1925-1929 = 100) to 140 in 1937.[1] Money wages in 1937 rose 7% higher than in 1929 and the rise in wages was further augmented by a fall of 5% in the cost of living.[2] The national income in 1937 shot up to £5,200 million from £3,850 million to which it had sunk during the depression.[3] In spite of all these phenomenal developments achieved by Great Britain, there were serious short-comings in the British recovery of the thirties. The unemployment figure in 1937 was higher than in 1929, 10.6% of the insured workers being without employment.[4]

U.S.A.

When the depression in U.S.A. absolutely touched the rock-bottom, the first Roosevelt Administration, on coming into office in March 1933, adopted an expansionist programme under the title of the 'New Deal.' The primary object of this programme at the beginning was not to expand production or to create employment but to grant relief to the destitute and the unemployed, to lighten the urban and rural indebtedness and to raise agricultural incomes. But out of these disjointed relief measures, a conscious policy of compensatory government expenditure gradually emerged. While at the beginning, relief expenditure constituted the main part, at the end public works assumed significant importance. The bulk of this expenditure was

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(1) "Industrialization and Foreign Trade", League of Nations, 1945. p. 140.

(2) " The Economic Lessons of the Nineteen Thirties", by H.W. Arndt, London 1944. p. 126.

(3) " The Economist," 15 April, 1939.

(4) "Full Employment in a Free Society", by W.H. Beveridge, London, 1945. p. 47

financed by budget deficits which amount to 13.5 billions in four years as shown below:[1]

Year	Million £
1934	3,600
1935	3,000
1936	4,200
1937	2,700
Total	13,500 millions

Though public investment formed a good part of this huge expenditure yet several deterrent factors minimised its significance to a very serious extent. During these years, when the Federal Government was expanding public works expenditure, the local and state governments were reducing their public works expenditure which declined from 3 millions in 1929 to 1.1 millions in 1935.[2] The investments of the Federal Government could not make good this decline. During the prosperity boom of 1923-29, the average total investment expenditure amounted to £ 18,500 million a year out of £ 77,000 millions of average national income.[3] In 1933, total investment expenditure stood between £ 5,000 and £ 6,000 million and by 1937, it rose between £ 12,000 to £ 13,000 million.[4] Thus, the increase of public investment fell far short of the decline in private investment and the effect of a deficit budget was restricted to the stimulation of consumption expenditure only.

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(1) "The Economic Lessons of the Nineteen Thirties", by H. W. Arndt, London, 1944 p. 60.

(2) Ibid p. 62 footnote

(3) Ibid p. 61

(4) Ibid p. 61

During the four years from 1933 to 1937, when the government stimulated private consumption expenditure by an enormous sum, there took place a substantial increase in the economic activity of U.S.A. The index of production (Federal Reserve Board, 1923-25 = 100) rose from 64 in 1932 to an average of 116 for the first nine months of 1937 while it stood at 121 in 1929.(1) Thus even in 1937 industrial production stood at a level 5% lower than in 1929. The national income rose from $ 40,000 million in 1932 to $69,800 million in 1937 while in 1929 it stood at $81,100 million.(2) Even if allowance was made for the low price-level of 1937, the national income in the later date stood below the 1929 level.(3) The recovery attained by America was, therefore, anything but satisfactory. While in 1929 the unemployment figure stood at three millions, there were over eight millions of people without work in 1937.(4)

GERMANY

With Hitler in power in January 1933, the Nazi Government adopted an expansionist policy based at first on public works and later mainly on the rearmament programme. More than two and a half milliard RM was spent in 1933-35 on public works comprising the construction of strategic motor roads.

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(1) "The Economic Lessons of the Nineteen Thirties", by H.W. Arndt, London, 1944 p. 60

(2) Ibid p. 60

(3) Ibid

(4) Ibid p. 61

ordinary roads, public buldings, waterways, state railways, land improvements etc. By the end of 1934, in addition to the normal budget expenditure, government spent more than five milliard RM.(1) The whole of this expenditure stimulated consumption demand and increased private investment(from 440 million RM in 1932) to 1070 million RM in 1934(2) and the index of industrial production increased from 70.2 in 1932 (base :1913 = 100) to 101.8 in 1934.(3) The unemployment figure was reduced by more than three millions.(4) The indirect demand-stimulating effect of this huge expenditure would probably have urged the private entrepreneurs to undertake investment to the level of full employment in due course, but entrepreneurs were not given this chance, because from that time economic policy was changed from recovery to rearmament and government expenditure for the latter purpose increased by leaps and bounds. From 12.2 milliard RM in 1934-35 government expenditure increased to 22 milliard RM in 1937-38 , while gross public investment increased from 4.1 milliard RM to 8 - 9 milliard RM.(5) Private investments also increased from 1.07 milliard RM in 1934 to 2.1 milliard in 1936 .(6)

These huge public and private expenditure not only created

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(1) "The Economic Lessons of the Nineteen Thirties" by H.W. Arndt, London, 1944. p. 155.
(2) Ibid . p. 156.
(3) "Industrialization and Foreign Trade", League of Nations, 1945. p. 134.
(4) " The Economic Lessons of the Nineteen Thirties ", by H.W. Arndt, London 1944. p. 155.
(5) Ibid. p. 156.
(6) Ibid.

full employment in Germany, but over full employment. From 1935, the problem of the government was how to divert resources of production which were running short from consumption goods industries to armament factories. By 1937, there was absolutely no unemployment but an acute shortage of skilled labour. The industrial production rose from 70.2 in 1932 (base: 1913 _ 100) to 138.1 in 1937.(1) It was thus much higher than the level of productivity in 1929 with an index of 117.3.(2) The total national income increased from 45.2 milliard R M in 1932 to 68.5 milliard in 1937.(3) Germany thus attained full recovery from depression.(4)

FRANCE.

In 1928 France stabilized her currency at 1/5th of its pre-war value and this gave her export industries such a great competitive exchange advantage that she was practically unaffected by depression up to 1930.(5) But the exchange depreciations of 1931 and 1933, as well as other trade restricting measures in her export markets more than eliminated her exchange advantage and plunged her into the depths of depression from which she could not completely extricate herself during the thirties. France did not adopt monetary

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(1) "Industrialization and Foreign Trade", League of Nations 1945 p. 134.

(2) Ibid.

(3) "The Economic Lessons of the Nineteen Thirties", by H. W. Arndt, London, 1944. p. 171.

(4) "The Economics of Full Employment", Oxford Institute of Statistics, Oxford, 1945 p. 201-203.

(5) "The Economic Lessons of the Nineteen Thirties", by H. W. Arndt, London 1944 p. 135.

measures as did Great Britain, U.S.A. and Germany to increase her effective demand and stimulate internal economic activity. From 1931 to 1935, the French Government maintained the gold-standard by a policy of deflation which aggravated that economic depression continuously.(1) The index of her manufacturing production declined from 122.6 in 1931 (Base: 1913 = 100) to 109.1 in 1935.(2) In 1936, the Front Populaire came to power and adopted an expansionist programme on the American New Deal model. But political difficulties and flight capital combined to frustrate this policy within nine months and this brief revival of economic activity was followed by another spell of depression which continued during the remaining years of the thirties.(3)

Thus, the expansionist policies of the four major economies attained widely different results. At one end was Germany, which expanded effective demand to the level of full employment and even beyond, while at the other end stood France with a declining effective demand. The increases in effective demand of the two other major economies stood in between those of Germany and France. Great Britain, with a considerable increase of effective demand was closer to Germany than France, while U.S.A., with a modest increase stood between Great Britain, on the one hand, and France on the other.

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(1) "The Economic Lessons of the Nineteen Thirties", by H.W. Arndt, London, 1944 p. 138-140.

(2) "Industrialization and Foreign Trade", League of Nations, 1945. p. 134.

(3) "The Economic Lessons of the Nineteen Thirties", by H. W. Arndt, London, 1944. p. 141 - 150.

The excess effective demand over the full employment level in Germany was not effective beyond her boundaries because Germany did not possess any foreign exchange to liquidate her consequent unfavourable balance, nor were the foreign countries willing to allow much credit to Germany. In view of these facts, the excess effective demand of Germany could not in any way make good the deficiency in the increase of effective demand in other major economies. Now, the total effective demand of the four major economies constituted the bulk of the world's effective demand. But complete depression in one of the major economies (France) and semi-depression in two others (U.S.A. and Great Britain) kept the global effective demand much below the global productive capacity. The buyers' market which developed after the collapse of the world demand in 1929 continued even after the application of recovery measures, involving the regulation of both the demand for and supply of money by most of the major economies. The rest of the world, comprising the minor economies was thus still afflicted with a net deficiency of world demand, which kept their economies depressed and their production and employment below normal.

SECTION 3. J.M. Keynes and the Full Employment Policies in the Late Thirties.

Before 1936, the demand stimulating measures adopted by the different major economies were not directed to the attainment of full employment as such. They were either recovery or anti-cyclical policies and their aim was at best to carry their

respective economies back to the pre-depression level of economic activity. Full employment attained in Germany was incidental to the rearmament programme. In 1936, J.M. Keynes published his famous work "The General Theory of Employment, Interest and Money" in which he convincingly argued that full employment as such should be the continuous objective of monetary policy and that public investment by making deficit demand effective, was capable of attaining and maintaining full employment, provided investment was sufficient in volume and suitable for the purpose. The full employment theory as further embellished by Keynes himself and his followers was gradually epitomised in the theory of the full employment budget of compensatory public investment to make up the deficit in private investment so that full employment be continuously maintained. Keynesian analysis provided the explanation why full employment was attained in Germany while the same could not be attained in U.K. or U.S.A. It was realised that adequate public investment was the cause of full employment in Germany while its absence or insufficiency was at the root of depression or semi-depression in France, U.S.A. and U.K.

The full employment theory eventually captured the imagination of the scientific world and received the adherence of a wide circle of supporters but none of the three half-depressed major economies adopted it as a basis of their economic policy. On the other hand, as a basis of policy the theory suffered a setback in America in 1937. In the spring of that year there developed a short but sharp boom in U.S.A. originating mainly from the payment of veterans'

bonus by the Government and a consequent sudden increase in consumers' demand. The political opponents of the New Deal raised a hue and cry about the impending inflation and compelled the administration to curtail its expenditure which fell from $ 4,100 million in 1936 to $ 985 million in 1937.(1) The reduction of government expenditure not only checked inflation but set on foot from September 1937 a deflation and depression much more precipitate than that of 1929. From October 1937 to March 1938, some four and a half million workers lost their jobs.(2) The index of production of the Federal Reserve Bank fell from 116 in the first six months of 1937 to 75 in July 1938.(3) From $ 72,000 million to which it had risen in 1937, the national income fell to $ 50,000 million by the beginning of 1938.(4) By March 1938, it was realized by all that without the resumption of government expenditure on a huge scale it was not possible to avoid another Great Depression. In July 1938, a new programme of expenditure on relief and public works was launched again and the recovery began as sharply as the decline had developed in the previous year. By the end of 1938, employment increased by 1.2 millions and production regained the early 1937 level.(5)

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(1) "The Economic Lessons of the Nineteen Thirties", by H.W. Arndt, London, 1944. p. 69.
(2) Ibid.
(3) Ibid.
(4) Ibid.
(5) Ibid.

The debacle of 1937-8, clearly demonstrated to what a great extent the economic activity of U.S.A. depended on the government expenditure.(1) But even then, public investment was not developed in America before the end of 1939 to such an extent as to attain full employment. Moreover, the short but sharp American depression of 1937-1938 caused a severe decline in the effective demand of the world and a corresponding world depression during this period. In France and Great Britain also, public expenditures increased during 1937-39, probably partly under the influence of this theory but mainly for rearmament. But despite these increases, full employment was not attained before the end of 1939. Thus, in all the three major economies, in U.S.A., U.K. and France, effective demand remained persistently below their productive capacity throughout the thirties. Neither anti-cyclical recovery policies of the early thirties nor increasing public investments of the late thirties adopted by the major economies could entirely extricate them from depression and thereby increase the global effective demand to the level of productive capacity of the world. The global buyers' market continued up to the end of 1939. when huge rearmament programmes rapidly forced up their economies to full employment.

In Germany full employment was attained before the full employment theory was enunciated in 1936. But the later

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(1) " Monetary Policies and Full Employment", by W.J. Fellner, California, 1947. p.197.

experience of the German full employment policy revealed the limitations within which such a policy was to be restricted and the conditions that were to be fulfilled for its complete success. The volume of German investment expenditure was much greater than was necessary for German full employment and the consequent income and consumption demand of the German people were much greater than the volume of consumption goods produced in Germany. Germans were naturally eager to purchase more consumption goods from outside and this automatically turned the balance of payments against Germany. But German exports could not be increased because a substantial part of her productive potential was engaged in the rearmament programme which did not provide any exportable ware. Moreover rearmament production itself required more foreign raw materials which turned the balance of payments against Germany all the more. The excess purchase of Germany in the Buyers' market of the thirties was definitely of advantage to her. From many countries she succeeded in purchasing a fair amount of materials against blocked paper marks which offered very little prospect of realization. But this game of purchasing without payment did not proceed very far. Despite the existence of a buyers' market, most of the countries soon refused to sell anything to Germany without being paid back with real goods (or gold). But that was not possible for Germany without converting her armament factories into factories to produce useful exportable commodities. Hence,

though it was possible to attain full employment by unproductive investment, it was bound to reduce consumption or the standard of living of the people and was not, therefore, worth having from an economic point of view.

Even if it could be assumed that all the German armament factories were converted into industries for the production of useful exportable goods, still it would not be possible for Germany to liquidate her deficit balance entirely by increasing her exports. Due to overfull employment in Germany, German consumers would have purchased much more from outside but, the rest of the world (due to its deficiency of demand) would have bought less from Germany. The German deficit balance could in those circumstances be liquidated either by decreasing German effective demand and thereby German purchases or by increasing foreign effective demand to increase foreign purchases of German goods. In the former case, the German level of economic activity would be reduced to the half depressed level of other major economies while in the latter alternative the economic activity and employment in the other major economies would be forced up to the level of full employment. Thus, full employment could be attained only by co-ordinating the policies of the major economies - that is, only when all of them maintained full employment individually. Only then would global effective demand have equated world productive capacity. The rest of the world comprising the minor economies would have had their productive activity automatically stimulated

by the expanded world demand and could have emerged out of the depression without any conscious effort on their part.

In fact, neither were German industries devoted to the sole production of useful goods nor had the other major economies full employment. Due to these reasons, global effective demand remained much lower than the productive capacity of the world throughout the thirties and depression in the economic activity of the world persisted. This made the German full employment activity to be attained and maintained only at the cost of German consumption and standard of living. The minor economies of the world continued to be afflicted by the depression during the thirties as a result of the deficiency in the global demand. In the face of this world deficiency in demand, if a minor economy adopted a full employment policy, its productivity would have been extremely low and its full employment could be attained only by a serious sacrifice of the consumption and standard of living of its people.

SECTION 4. The Internal Aspect of Indian Monetary Policy from 1931 to 1939.

The depression with which India was afflicted after 1929 was, as we have already seen, nothing but a reflection of the world depression caused by the collapse of the world demand, particularly for agricultural products. India, with her agricultural exports and her inelastic system of agricultural production, was encumbered with an unsaleable stock in a shrinking market.(1)

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(1) "Review of the Trade of India in 1936 - 37." pp. 1 - 3.

Partial recovery in the world economic activities brought about by the expansionist measures of the major economies could, under normal circumstances, be expected to increase the demand for Indian exports. But this was not the case, firstly because the recovery attained was very incomplete and inadequate and the world demand remained throughout the thirties much short of the productive capacity of the world.(1) Secondly, the fundamental characteristic of the recovery measures of the thirties was to divert production from export goods to commodities of domestic consumption. Recovery being thus mainly of a national character did not bring about a commensurate increase, in international trade.(2) While global production rose above the 1929 level by 1936, international trade was still much below the 1929 level. The quantum of Indian exports moved with the world trade and touched the lowest level in 1932-33 and was nearly the same as the quantum of world trade in that year. From that time, it increased very slowly, but even in 1936, it was 12 points below the 1927-28 level.(3) The quantum of Indian export in the following year, (1936-37) rose to 107.4, consequent upon the expansion of world demand due to the rearmament programme of several countries. But the short but sharp American depression of 1937-38, lowered the

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(1) "Industrialization and Foreign Trade", League of Nations 1945 p 141 and 161.

(2) "Review of the Trade of India in 1936-37" p. 1-3.

(3) Ibid p. 2 and p.28

Quantum of Indian export trade again which stood at 103.1 in 1937-38 and 102.2 in 1938-39.(1) Now, the exports of India consisted mainly of agricultural products and raw materials. The base year (1927-28) for these quantum figures was the year of agricultural depression which seriously affected the export trade of India. Hence the international trade of the base year itself represented a depression level and it was only to this level that the quantum of Indian trade rose, eleven years afterwards.

But the rise in the quantum of Indian trade did not mean any mitigation of the Indian depression. Indian exports consisted mainly of agricultural goods, the production of which did not appreciably diminish during the depression years. Undiminished supply in a contracting market necessitated a serious lowering of Indian export prices to effect sales. Other agricultural countries encumbered with excessive exportable supplies mitigated the problem a little by accumulating and holding back stocks.(2) But, on account of the absence of any organization to hold back stocks, as well as the poverty of Indian farmers, the fall of prices of Indian exports was much greater than that of other countries. One of the manifestations of this fall of Indian prices was a greater decline in the prices of Indian exports in comparison with that of her imports as will appear from the following table.(3)

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(1) "Review of the Trade of India in 1938-39" p.72

(2) Ibid p. 4

(3) " Review of the Trade in of India in 1936-37" p. 28.

Price indices of Indian Exports and Imports (Base: 1927-28 = 100).

Year	Quantum of exports	Price level of exports	Price level of imports
1927-28	100	100	100
1928-29	106.1	97.5	96.4
1929-30	108.0	90.2	93.2
1930-31	96.6	71.5	80.0
1931-32	82.5	59.2	71.7
1932-33	74.9	55.3	65.2
1933-34	86.2	53.5	63.5
1934-35	87.8	54.1	63.0
1935-36	88.4	56.9	62.4
1936-37	107.4	57.2	62.8

The excessive fall in export prices reacted on the Indian price-level in general which recorded an almost continuous decline during the thirties as will appear from the index of wholesale prices given below.(1)

1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
100	82.3	68.1	64.5	61.7	63.1	64.5	64.5	72.3	67.6

Thus, the Great Depression in India took the form of a collapse of prices rather than shrinkage in production and this was mainly due to the inelastic system of the Indian productive organization.

The fall of agricultural prices reduced the income and standard of living of the Indian farmer very seriously. From 1931, the farmer had to make both ends meet by dishoarding his gold. The dishoarded gold in the first instance was lodged with money-lenders and gold dealers who had to export a part of this gold due to an excessive increase in their stock in trade. From 1931 to 1936 the value of gold

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(1) "Review of the Trade of India in 1936-37" p. 56 (Vide infra p.223.)

exported from India amounted to 267 crores.[1] More relevant in this connection was the fact that the fall in the income of the farmer made him a poor buyer of manufacturing goods but, on the other hand, Indian industries during the thirties enjoyed high and all round protection. With the home market at their entire disposal, Indian industrial production recorded a phenomenal increase during the thirties as shown below:

Annual indices of manufacturing production (2)
(Base: 1925 = 100)

1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
109.5	100.7	108.1	108.1	116.7	132.4	143	150.7	163.5	166.8

But this rapid increase of industrial production soon saturated the home market which had already become seriously truncated by the decline of the agriculturalist's income and his purchasing power of manufacturing goods. By 1936-37 signs of over-production became visible.[3] Prices of industrial products were on the decline. Jute, cotton, sugar, steel, tea, cement etc., recorded a persistent decline in prices.[4] Industrial profits were sinking again as shown below:[5]

1928	1929	1930	1931	1932	1933	1934	1935	1936	1937
100	78	47.1	27.8	34.6	44.2	62.6	69.2	63.1	61.1

It was now apparent that without expanding the domestic market which meant the increase of the farmer's income, it was

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(1) "Review of the Trade of India, 1931-32 to 1935-36"

(2) "Industrialisation and Foreign Trade", League of Nations 1945. p. 141.

(3) "Review of the Trade of India in 1936-37" p. 16.

(4) Ibid

(5) Ibid p. 31.

not possible to expand Indian industrial production any further. The main cause of the poor income of the Indian farmer lay in the deficient world demand for Indian exports - a deficiency which India could not remedy. Only if the major economies of the world stimulated their foreign demand to the pre-depression level, would the prosperity of the Indian farmer have been restored. But the major economies did not do this throughout the thirties and in consequence, the purchasing power of the Indian farmers remained at a subnormal level and blocked the progress of Indian industries.

The minor economies, however, could stimulate their internal demand to some extent at least by their own efforts and without any external aid. Sweden, for example, adopted from 1933 a policy of compensatory public investment, regardless of whether it was productive (self-liquidating) or not, to provide work as well as income to the unemployed. Unemployment reached its peak in Sweden in March 1933 but after the adoption of this policy, full employment was reached by 1937.(1) The national debt continued to grow but this increase was mainly accounted for by productive state investments, income from which was more than sufficient to cover debt services and most of that part of increased state investment, which was not profitable in the business sense, made useful additions to the nation's capital equipment. In addition, these investments

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(1) "The Economic Lessons of the 1930 's",
H. W. Arndt, London 1944, p. 212.

maintained the purchasing power of the Swedish people during the depression.[1] If a public investment policy of this type had been adopted in India during the thirties, the purchasing power of Indians could have been increased to some extent at least, and the economic activity of the country could have been correspondingly stimulated.

But nothing of the kind was done in India during the thirties. Some measures were of course taken to improve the lot of the farmer by lightening his mounting debt burden, the incidence of which became particularly heavy due to the fall of agricultural prices. Agricultural debts were scaled down by various methods of debt conciliation and compulsory reduction in many provinces, partly by voluntary arrangements and partly by legislation. But this policy, in addition to the scaling down of rural debts, dried up the very source of agricultural credit. The Government could not provide an alternative source of supply.[2] The Reserve Bank of India was brought into existence in 1935 and it had an agricultural credit department. But the work of the Agricultural Credit Department of the Reserve Bank consisted of research work in all aspects of rural credit rather than making provision for rural credit. The Government measures to scale down rural debts also resulted in the restriction of agricultural credit and thereby tended to check agricultural operations and the farmer's income rather than increase them. Indian monetary policy in

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(1) "The Economic Lessons of the Nineteen Thirties", H.W. Arndt, 1944, p. 213.

(2) "India's Post-War Reconstruction and its International Aspects" by P.S. Lokanatham, p. 2.

the thirties could not, therefore, stimulate internal economic activity which was regarded as the objective of monetary management of that period.

SECTION 5. International Implications of the Internal Expansionary Policies of the Major Economies during the Thirties.

One of the main objectives of the internal expansionary policies of the thirties was to make the industries of a country more and more independent of foreign markets. But the expansionary policies had the inherent tendency of making the country concerned more dependent on foreign countries in another respect. When the income and purchasing power of the people were increased by expansionary measures such as public investment, the new income earners not only purchased more domestic goods but also more foreign consumption goods. More-over, expanded investment activities automatically necessitated the import of more foreign raw materials while more domestic raw materials, which were previously exported, began to be utilized by expanded domestic industries. All these factors increased the imports of the expansionist country, decreased its exports and thereby turned the balance of payments against it.(1) Now, this deficit balance or net debts to the foreigners had to be settled in any case. Most of the major economies, particularly Great Britain and Germany, could not settle it by shipment of gold as they did under the gold standard regime. They could not also do it by a policy of deflation which would have been tantamount to giving up the expansionist policy itself. Hence, almost the only way to

(1) "Economic Journal", December 1946 "Art Deliberate Industrialization for Higher Incomes" p.550.

correct the deficit balance was to allow the exchange rate to depreciate to make exports cheaper and imports dearer, and thereby to increase foreign sales and decrease purchases from foreign countries. For every amount of deficit balance there was an appropriate low exchange rate which would restore equilibrium in the external payment of the country concerned. But this very potentiality of a lower exchange rate indicated the further fact that if the exchange rate were lowered below the equilibrium rate it was possible to have a favourable balance.(1) A favourable balance meant that a country sold more goods to foreign countries than it bought from outside, that is, it captured a corresponding extent of the foreign market for its domestic industries.

The capturing of the foreign market by exchange depreciation assumed an extraordinary significance after the collapse of the world market by the great depression.(2)

Competitive exchange depreciation, as this practice of capturing the foreign market was styled, began from 1928, that is, one year before the great depression started. In that year, France stabilized her currency at one-fifth of its value before World War I and this gave her a wide competitive exchange advantage.(3) Even before 1928, France was getting

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(1) "Monetary Theory" by G.N. Halm, Philadelphia, 1946, p.249.

(2) "The Economic Lessons of the 1930's" by H.W. Arndt, London, 1944 p. 32.

(3) Ibid. p. 135.

considerable advantage from her low exchange rate which helped her to have a continuous favourable balance from 1922 and accumulated a huge gold reserve - second only to that of U.S.A.(1) This gold reserve was more than sufficient to ward off any pressure on the franc in the first years of depression but, in fact, the use of this reserve was not needed at least up to 1931-32 because France did not have any deficit balance.(2) The depreciated franc gave her a decided competitive advantage over the dollar, sterling and mark and increased her foreign trade, particularly export trade, in 1928 and 1929. By the end of 1929, her export increased by 14% from the level of 1928 and this increase was maintained in 1930 as well. In a sense, France was not affected by the Great Depression at all up to 1931.(3) The exchange advantage reaped by France was naturally resented and envied by other major economies who were not unwilling to copy her method in their turn.

In 1931, when Great Britain was faced with acute balance of payments disequilibrium and forced off the gold standard, she allowed her currency to depreciate in two stages by 30%.(4)

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(1) "The Economic Lessons of the 1930's, by H.W. Arndt, London, 1944 p. 24.

(2) Ibid

(3) Ibid

(4) Ibid p. 99

In fact, Britain had no other alternative. If she tried to restore equilibrium by deflation that would have not only accentuated the exchange disadvantage from which she had been suffering until 1931 but would have involved the lowering of British income, imports, standard of living and increased unemployment and led to social conflict. Moreover, in the face of contracting world demand in 1930-31, British deflation would have contracted the world market to an immensely greater degree. As it happened, the depreciation of the sterling not only eliminated the overvaluation of the pound from which her export trade suffered so long, but it gave to British exporters a competitive advantage in the world market for at least two years after 1931,(1) at the same time giving protection on the British home market as opposed to the countries outside the sterling area. This depreciation was considered by Americans to have increased Britain's share of world trade by 16% during 1932 over her trade of the previous year and to have decreased the American share of world trade, (between 1929 and 1932) by 22%.(2)

In 1931 Germany was faced with the problem of a deficit balance, much more acute than that of Great Britain. The German Government could not, however, think of having recourse to devaluation so easily because public opinion in

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(1) "The Economic Lessons of the 1930's" by H. W. Arndt, London, 1944 p. 99

(2) Ibid p. 74

Germany identified devaluation with inflation from which Germans had suffered so grievously in the early twenties and which they did not want repeated again.(1) The German Government, therefore, tried to attain equilibrium by deflation even at the cost of political and labour strife but in the face of hot money movements and flight capital, this measure completely failed.(2) Even if the German Government tried to depreciate the mark, these hot money movements would not have allowed it to attain balance of payments equilibrium.(3) The rapid and unpredictable movements of huge volumes of capital from one country to another that began from 1931 and acquired the notoriety under the title of 'hot money' movements were an altogether new phenomenon and were responsible for aggravating the balance of payments difficulties of many countries. A fall in the exchange rate to correct an adverse balance of payments was taken as a danger signal of a further fall, so that funds, instead of flowing in, flowed out. As the fugitive funds took refuge abroad, pressure on the exchange market increased and resulted in a further loss of confidence and a further flight of capital. A dear money policy to stop this flight simply aggravated the situation. Funds in search of safety rather than employment moved from countries with a deficit balance to countries with a surplus, thus

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(1) "The Economic Lessons of the 1930's, by H.W. Arndt, London 1944 p. 181.

(2) Ibid p. 30 and p. 180

(3) Ibid p. 181.

aggravating any discrepancies already existing. This was true not only of flight capital or hot money but sometimes also of panic withdrawal of foreign short term credits.(1)

A country wanting to correct her deficit balance either by deflation or depreciation aimed at increasing her exports and decreasing her imports. But if at the same time a flight capital developed, the effect of deflation or depreciation to increase exports and decrease imports was sure to be negatived if not reversed. In September 1931 Great Britain was faced with the problem of the withdrawal of foreign funds, the financing of which absorbed the bulk of her foreign exchange . It was the excessive demand for foreign exchange caused by the flight of capital that exerted a strong downward pressure on British exchange and was the immediate cause of the suspension of gold payment and depreciation of the sterling. But the depreciation itself restored the confidence (in the sterling) of the people who sent capital abroad and the capital began to flow in Great Britain. Even if capital continued to flow out, Great Britain could have stopped the consequent further depreciation of the pound by exporting gold from the Exchange Stabilization Fund which she organized at the beginning of 1932. In fact from 1932 (2), Great Britain was faced with the opposite difficulty of inflow of capital and accentuated foreign demand for the pound

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(1) "International Currency Experience", League of Nations 1944. p.80, 162 and 187.
(2) " Ibid p.80.

which exercised an upward pressure on the British exchange rate.[1] The exchange rate of the sterling was not allowed to rise above 30% depreciation level by constant sale of sterling to the foreigners by the Fund on the one hand and simultaneous import and accumulation of gold in the Fund on the other.[2]

The policy of deflation in Germany could not however restore the confidence of the people who continued to send capital abroad and made her deficit balance yawn wider and wider . As the policy of deflation could not restore the confidence of the speculators, a depreciation of the mark, even if Germany could adopt such a policy, would have done it even less. To make either a policy of deflation or devaluation successful it was essential for Germany to neutralise the hot money movement . But Germany did not possess sufficient liquid resources to organize an Exchange Stabilization Fund like the one in Great Britain. To meet the deficit balance Germany had no other alternative than to devise a rationed

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(1) " International Currency Experience ", League of Nations, 1944. p. 143.

(2) " The Economic Lessons of the Nineteen Thirties by H.W. Arndt, London 1944, p. 98.

adjustment of scarce foreign exchange among the importers who demanded a much bigger amount. For this purpose the government took over all the available supply of foreign exchange and (fairly) distributed it among the applicants in some proportion.(1) Exchange control automatically reduced imports to the level of available foreign exchange or exports. This in turn meant that internal production was inevitably modified and adjusted to the pattern of foreign exchange rationing adopted by the German Government.(2) Shortly after Germany, France also adopted a variant of exchange rationing in the form of import control.

Exchange devaluation of Great Britain and Exchange Control of Germany and France seriously affected the American export trade; at least Americans believed that they had such effects. During the depression years, U.S.A. developed a strong positive balance and was having a constant influx of gold.(3) This gold import had a tendency to raise the American price-level and inconvenience her export trade all the more. By adopting a policy of gold sterilization, America neutralised the price raising effect of the bulk of

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(1) "The Economic Lessons of the 1930's" by H.W. Arndt, London 1944 p. 180.

(2) "Monetary Theory", by G. H. Halm, Philadelphia 1946 p.243 -p.247.

(3) A part of this gold in consequence of American favourable trade balance, was diverted to Europe between 1931-1933 by short term capital movement. But after 1933 short term capital movement was reversed and gold began to enter into America in huge quantities.

the imported gold. By thus withdrawing gold from monetary circulation, America raised the world price of gold to the level of the deflated dollar and thereby tried to maintain her export trade. But this gold neutralization policy by itself could do very little either to stimulate American export trade or to mitigate her internal depression. To stimulate her exports to a much greater degree, in support of the domestic expansionary policy of the New Deal launched in 1933, America decided to devalue the dollar that year. President Roosevelt got the authority of congress to devalue the dollar to the extent of 50%, but actually it was devalued to the extent of 41% only.(1) The devaluation of the dollar not only removed its overvaluation, even if it had any, but it gave America an exchange advantage over others which amounted to the raising of American tariffs by 60% and an export bounty of 40%.(2) This exchange advantage did not disappear until at least 1935 or 1936. The dollar devaluation led to an almost immediate increase of American exports by about 100%.(3) But this increased American export increased world disequilibrium vis-a-vis America. Even before devaluation, U.S.A was having a substantial favourable balance and from 1931 to 1933, a huge volume of short term funds moved from America to European countries and met the bills for the net European

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(1) "The Economic Lessons of the 1930's", by H. W. Arndt London, 1944 p. 74

(2) Ibid p. 75

(3) Ibid p. 76

imports from U.S.A. But after devaluation and restabilisation of the dollar, the direction of hot money movement was reversed and flowed towards America. This increased the unfavourable balance of the European countries very greatly and from 1934, America began to receive a huge inflow of gold, the bulk of which she sterilised and kept away from her monetary circulation.(1)

The devaluation of the dollar certainly removed the exchange advantage of the pound, even if it had any at that time, in addition it made it definitely overvalued vis-a-vis the dollar. But Great Britain could not possibly hope to remove this overvaluation of her currency by a fresh devaluation. In April 1934, U.S.A. organised her exchange Stabilization Fund mainly to stop any further devaluation of the pound.(2) The sheer size and offer of her stabilization fund to purchase sterling at the new rate was more than sufficient to frustrate any British effort to devalue her currency any more.(3) An almost continuous increase of gold by the British Stabilization Fund was caused, amongst other factors, by the constant upward American pressure on the sterling. By this rate war, America deprived Great Britain, Germany and France of much of their potential markets.

Though the path of depreciation was not open to Great Britain, France and Germany, they had to take other defensive

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(1) "The Economic Lessons of the 1930's" by H.W.Arndt, London 1944. p. 76

(2) "International Currency Experience", League of Nations, 1944 p. 144.

(3) Ibid. p.

measures to maintain their balance of payments equilibrium. Great Britain had to protect her markets by an expanding Imperial Preference scheme and asking the Colonies to extend preference to British Empire goods, which they did by further increasing import duties and giving rebates to Empire products.(1) Germany had protected her currency and balance of payments equilibrium by exchange control and after devaluation of the dollar she was driven still further to have recourse to bilateral controlled trade.(2) France and other European countries which were even then clinging to the gold standard were the hardest hit. They were forced to a much greater measure of deflation as well as additional restrictions on their imports. Prices in France were reduced by 16% during the year 1934.(3) The import surplus was reduced to about one hali Eventually France had to depreciate her currency but it was not within her power to do so without the consent of U.S.A, and U.K. Fortunately by 1936, both U.S.A. and U.K. were impressed that depression in France did not after all stimulate their export trade. France, therefore , succeeded in concluding the Tripartite Monetary Agreement that year with U.S.A. and U.K. and, thereby securing herself against retaliatory depreciation , devalued the francs by 25% in 1936 .(4)

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(1) "The Economic Lessons of the Nineteen Thirties" by H.W. Arndt, London, 1944 p. 106.

(2) Ibid p. 75.

(3) Ibid p. 75 and 76.

(4) Ibid p. 143.

Devaluation was followed by a considerable degree of improvement in the French economic activity for about nine months. But the abandonment of the gold standard gave rise to a flight of capital with which the French Exchange Stabilization Fund and the entire French gold reserve could not cope.(1) The intervention of the British and American Exchange Equalization Accounts in support of the franc was not of much avail.(2) The persistent flight of capital completely frustrated the French reflation policy.(3) The competitive exchange depreciation which was started by France in 1928 with a considerable advantage, ended with France in 1937 with complete discomfiture to herself, despite the support of her former victims.

The Great Depression by causing a serious shrinkage in the world demand, led the various major economies to recreate their demand by reflationary measures on autarchic lines. But as their reflated demand remained short of the global productive capacity, there was a standing cause for scramble among them for market. If the rate of reflationary measures in the different major economies had been equal, the scramble for market could not have made its appearance. But as the rate of reflationary measures was different both in timing and intensity, the struggle for

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(1) "The Economic Lessons of the Nineteen Thirties" by H.W. Arndt, London, 1944, p. 144.

(2) Ibid p. 144.

(3) Ibid p. 144.

markets was waged among them almost continuously throughout the thirties.(1) In the course of that struggle the international trade of the world was blocked by all kinds of restrictions If these obstacles to trade related only to the extended part of production effected by reflation, the new production would have been a net gain to the world. But the struggle for market extended restrictions to that part of the trade (and thereby to production) of the world which had existed before the reflationary measures were adopted and thereby throttled a part of this pre-reflation trade. Because of the blocking of a part of the pre-reflation trade, some goods that were formerly procured through international trade had now to be domestically produced. This clearly directed the resources of production from more productive to less productive channels. For this reason, increased production under the reflationary policies was not followed by a commensurate increase in international trade. Moreover, the gain in that part of international trade that continued was much reduced because production in different countries did not strictly follow the lines of the geographical division of labour. The following two tables giving the statistics of production and trade of the major economies and the world during the thirties reveal clearly the lag of international trade to production:

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(1) "Money" by D. H. Robertson, London, 1948. p. 189

Growth of Manufacturing production during the thirties: (Base: 1925-1929 = 100)
(1)

Year	U.S.A.	U.K.	Germany.	France.	World.
1929	112.7	109.9	107.9	112	113.3
1930	92.3	100	93.5	109.8	101.6
1931	75.8	90.3	78.3	96.2	90.5
1932	58.4	90.4	64.6	82.7	80.1
1933	69.7	96.7	73	94	89.9
1934	75.8	109.7	93.7	87.4	100.8
1935	87.5	118.2	107.4	85.6	114.2
1936	106.6	130.4	117.3	91.3	131.6
1937	115.8	140	127	97.2	144.7
1938	89.2	128.8	137.4	90	135

The indices of manufacturing production in all the major economies as well as in the world in the late thirties, exceeded the high-water-mark of production in 1929. The declining tendency of production in 1938 was caused by the short but sharp American crises of that year. The decline was, however, arrested and reversed immediately after. In contrast to this general growth of production, international trade in the late thirties was decidedly lower than the level it attained in 1929.

Trade in manufactured articles during the thirties (Base: 1913 = 100)
(2)

Year	U.S.A.	U.K.	Germany	France	World.
1926-29	157.3	97.4	86.1	79	104.3
1930	135.9	93.5	89	92.7	99.7
1931-35	86.7	66.8	66.3	68.4	75.5
1936-38	124.0	77.2	66.9	49.4	92.1

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(1) "Industrialization and Foreign Trade", League of Nations. p. 140.

(2) Ibid p. 157 and p. 162

Thus, the international trade of 1936-38, though higher than the depression level of 1931-35, was much lower than the average of 1926-29, proving thereby that the growth of international trade was anything but commensurate with the growth of world production. Hence the new increased production was attained at least partly at the cost of the advantages of the international division of labour, which was recognised up to the twenties of this century as the objective of monetary management. The monetary policies of the thirties which aimed at stimulating domestic economic activity did so, at least partly, by sacrificing this external objective.

SECTION 6. The plight of the Minor Economies in the Currency Struggle among the Major Economies. The Currency blocs of the Thirties.

The autonomous reflationary policies of the major economies in the thirties exercised on the whole a beneficial expansionary effect on the rest of the world comprising the minor economies. But this expansionary effect did not come to the latter in proportion to the expansion of production in the major economies or global production, but at the much lower rate of the expansion of international trade, through which this beneficial effect was spread among the minor economies. Moreover, due to the deflection of production in the major economies from more productive to less productive channels, the gain from international trade was reduced and this qualitative deterioration could not but have diminished the advantages from international trade derived by the minor economies. It was of course open to the minor

economies to 'undertake' autonomous and autarchic reflationary policies themselves. But due to the smallness of their economies and/the restricted scope of division of labour within, their autarchic expansionary policies were bound to be immensely less inefficient than those of the major economies. For this reason, the expansionary policies of the minor economies in the thirties, could not attain any spectacular success. The external stimulus was thus much more potent to reflate their internal economies than their domestic expansionary policies. The deficiency in the external stimulus during the thirties was, therefore, an immensely greater handicap to them than it was to the major economies.

In the course of the currency struggle of the thirties, every major economy defended itself with the elaborate armour of tariffs, exchange control, exchange devaluation, import control, quota, bulk purchase and even direct barter. The minor economies found the world market split up into as many units as the number of major economies (1) and with each unit they had to carry on trade, but subject to these restrictions. Being in dire need of carrying on trade, they had to enter into various types of bilateral trade agreements such as clearing and payments systems, reciprocal arrangements, quota system, bulk-purchase and even direct barter of commodities. These international barter arrangements, however, opened up a new possibility for the minor economies to have a free exchange system with a major economy by simply releasing this

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(1) "The Great Depression," by Lionel Robbins, London, 1936. p. 96.

mutually advantageous trade from all restrictions. But such a free exchange arrangement by a minor economy could not be extended to the other major economies, simply because one major currency could not be multilaterally converted into another. Hence, the alternatives open to a minor economy were either to have bilateral barter arrangements with each of the major economies or to have a free exchange arrangement with one major economy and barter arrangements with all the others. In fact, most of the minor economies of the world grouped themselves, each with one major economy, and formed the three or four currency blocs of the thirties. Within each of these blocs there was no exchange control and trade was more freely conducted within than between these blocs. (1)

The gold standard countries of Europe found themselves forming a currency bloc with France as the centre, and it continued until 1936 when France devalued her currency. But this was not a consciously framed monetary area and various kinds of restrictions in their mutual trade abounded. Partly for the latter reasons, but mainly because these gold standard countries were particularly depressed, this area could not develop into a monetary bloc in the true sense of the term, where trade could have some special facility to develop.

U.S.A., under the Cordell Hull system, developed a type of dollar area within which trade became slightly freer. The Trade Agreement Act of 1934 provided the legal basis for a

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(1) "The Reconstruction of World Trade" by J.B. Condiffe, New York, 1940 p. 232 - 262.

policy of bargaining with foreign countries for reciprocal reduction of trade barriers subject to a maximum reduction of 50% of the American import duties.(1) Bilateral bargaining was to be reconciled with multilateralism by the inclusion of the unconditional most-favoured-nation clause in all trade agreements. Between 1934 and 1939, U.S.A. concluded trade agreements with twenty countries half of these being with the tropical and semi-tropical countries of Latin America which depended largely on the American market.(2) The system of trade agreements covered by 1938, 60% of America's foreign trade.(3) More than half of her exports to the agreement countries, comprising about 30% of her total exports (on the basis of the export trade of 1937) received concessions.(4) U.S.A. also had to give concessions in return and reduced import duties on the 45% of her dutiable goods over and above the assurance that she would continue to retain 65% of the imports on the free list untaxed.(5)

The results of these trade agreements were not unsatisfactory. Though the volume of American foreign trade in 1937 was only about 75% of what it was in 1929, yet her share in the world trade increased from 9.9% in 1933 to 11.8% in 1937, that is, by about 20%.(6) Moreover, while the American

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(1) "The Economic Lessons of the 1930's" by H. W. Arndt, London, 1944. p. 81.
(2) Ibid p. 81-82
(3) Ibid p. 83
(4) Ibid p. 83
(5) Ibid p. 83
(6) Ibid p. 87

export to agreement countries increased at a faster rate than to non-agreement countries the share of the agreement countries in American imports appreciably declined.(1) Thus U.S.A. made a good bargain by increasing her net exports to agreement countries and thereby appropriating a part of their market. Although the latter lost a part of their market to America, probably they would have been still worse off if the trade agreement system had not developed this additional trade.(2)

The currency bloc that developed round Germany was more impressive than the American dollar area. When in 1934, the German exchange control system nearly broke down by sheer scarcity of foreign exchange she adopted the so-called New Plan to conduct foreign trade by a system of clearing agreements.(3) Under this system Germany entered into agreements with as many countries as possible, to establish one account in Germany and another account in each agreement country to which importers deposited the value of their imported goods in their own currency but to the credit of the foreign exporter. To maintain the equality of accounts with every country, Germany had to change the her exchange rate constantly to keep the purchase and sale at parity. This resulted in a multiplicity of exchange rates, not only with different currencies, but also with the same currency for each major transaction. The clearing system was thus developed into a form of direct barter

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(1) "The Economic Lessons of the 1930's" by H.W. Arndt, London, 1944, p. 86

(2) Ibid p. 84
(3) Ibid p.185

and transacted nearly 65% of Germany's foreign trade without requiring any gold reserve.[1] Germany had absolutely no gold reserve and her foreign trade had nearly come to a dead stop because of the shortage of foreign means of payment. The clearing system revealed a new vista of international trade and enabled Germany to resume her foreign transactions.

In the buyer's market of the thirties when sellers were very eager to sell but buyers were so few, Germany easily entered into clearing agreements with a host of countries and began to purchase freely. In no time other countries accumulated huge volumes of marks to their credit while German exports had little foreign currency to their credit in foreign accounts.[2] Foreigners found it very difficult to liquidate their marks because they could not procure from Germany sufficient goods of suitable kind which they would like to buy. It now appeared that they had sold goods without being paid. A number of Western European countries such as France, Switzerland and Holland refused to send further exports to Germany without being paid.[3] But this course was not open to countries of South East Europe or some of the countries of Latin-America which were saddled with excess supplies of exportable agricultural goods for which Germany seemed to be the only buyer.[4] As their

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(1) "The Economic Lessons of the 1930's by H.W. Arndt, London, 1944, p.186.
(2) Ibid p. 192-195
(3) Ibid p. 192
(4) "International Currency Experience", League of Nations 1944 p. 180.

clearing accounts accumulated and the Balkan exporters could not get their payments, they were urged by their governments to purchase manufactured goods from Germany rather than elsewhere. By thus accumulating clearing debts, Germany increased her economic stranglehold on the Balkan countries to such an extent that she could easily turn the terms of trade in her favour. Anyway, it must be admitted to her credit that although she exploited her position to some extent she did not do it to any serious extent until 1939 for political reasons.(1)

It is undoubtedly true that the clearing system plan reduced 80% of German foreign trade to bilateral barter and thereby automatically led to the abandonment of the advantages of comparative costs which she derived by selling her manufacturing goods to the industrial countries of Europe and purchasing foodstuffs and raw materials overseas.(2) But under the circumstances of the thirties no other alternative was open. As Germans had no foreign means of payment, the volume of international trade which was made possible by the clearing system, would not have been forthcoming at all.(3) The share of Germany in the world trade increased from 9.05% in 1933 to 9.2% in 1938.(4) In the face

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(1) "The Economic Lessons of the 1930's", By H.W. Arndt, London 1944, p. 192-195
(2) Ibid p. 200
(3) Ibid p. 198-199
(4) Ibid p. 200.

of overfull employment in Germany, even this slight increase should be considered as a significant achievement. Even the Balkan countries which were exploited most by Germany cannot be said to have been net losers. Despite their exploitation, they were better off then in the position to which they would have been reduced if Germany refused to buy their products.(1) The New Plan was really a new method of international trade which brought into existence some trade which would not have otherwise taken place and thereby benefitted all concerned.

While the dollar area and Reichsmark area were organized by the major economies and enlisted the affiliation of the smaller countries, the sterling area, the most significant currency bloc of the thirties was organised by the minor economies comprising the countries of the British Empire and a few other non-Empire countries depending on the British market, by deciding in 1931, to keep their exchange rates stable in terms of the sterling.(2) While a number of these countries maintained the old parity with the sterling, the majority of them adopted a rate lower than their old parity to suit their own convenience and without any opposition from Great Britain. Some of them readjusted their rates subsequently after stabilization in view of changed circumstances. In no case did a sterling area country adopt a rate above its old parity. After de-linking from gold in

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(1) "The Economic Lessons of the 1930's", by H.W. Arndt, London, 1944 p. 204.

(2) "International Currency Experience", League of Nations. 1944 p. 47.

1931, sterling depreciated to the extent of 30% in terms of gold. Hence even the countries which did not change their old parity with sterling enjoyed a depreciation to that level in comparison with countries outside the sterling area. There was no exchange control within the sterling bloc which represented a vast area where exchange was completely free in a world with all kinds of trade and exchange restrictions.(1)

It was not difficult for the minor economies of the sterling area to maintain parity. In addition to the fact that they started in 1931 with an equilibrium rate and could readjust it if necessary, Great Britain during the thirties, due to her quick recovery from depression, was a rapidly developing market and this enabled the member countries to accumulate sufficient sterling with which they could meet temporary set backs in their balance of payments, without reducing their exchange rate.(2) The control of foreign capital issues, imposed on the U.K. in 1931-32 was relaxed for sterling area countries which wanted to borrow funds from London in support of their currency.(3) In fact, no such loans were needed to any appreciable degree because the ordinary trade balance of the member countries proved quite adequate on the whole.

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(1) "International Currency Experience", League of Nations p. 50-54
(2) Ibid p. 54-60
(3) Ibid

As the sterling area was a voluntary association from which a member country could withdraw at any time, there was no possibility of the minor economies being exploited by the U.K. as was the case in the dollar area or the Reichs mark area.(1) But in the accumulation of sterling by the member countries lurked a possible danger. If Great Britain, like Germany, was ever compelled to make excessive purchases from the sterling area countries, the sterling balances of the member countries would be frozen like the mark-balances of the Balkan countries. During the thirties however, sterling area countries were not faced with this problem.

On the other hand, Great Britain was not put to any serious difficulty by being made the centre of the sterling area. The expansionary policy which Great Britain was following at that time had no fear of being thwarted by an unfavourable balance of payments from sterling area countries because she could use her own currency as a means of settlement throughout the area. As the other countries considered sterling to be their essential foreign exchange reserve, the unfavourable balance of Great Britain was adjusted by automatic loans from the member countries.(2) But Great Britain had a special responsibility for the sterling area as a whole vis-a-vis the non-sterling area.

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(1) "International Currency Experience", League of Nations, 1944 p. 54-60
(2) Ibid p. 61-64

She had to keep gold reserves to meet the deficit balance, not only of herself but of the whole of the sterling area in relation to the outside world.(1) The fluctuating balance of payments of member countries with the outside world could thus easily affect the gold reserves of Great Britain. The difficulty of Great Britain and the sterling area in the late thirties came from U.S.A. and the dollar area which maintained a favourable balance on current account with the sterling area.(2) U.S.A. did this by so operating her Exchange Stabilization Account as to maintain an overvaluation of the sterling and the position of the sterling could any moment be threatened by a change of American policy on this point.

Great Britain safeguarded her situation as well as that of the sterling area vis-a-vis the dollar by adopting a policy of general tariff and bilateral agreements of tariff concessions with non-Empire countries. Great Britain of the thirties was the biggest import market of the world and in the buyers' market of that time she drove very hard bargains and succeeded to secure very valuable concessions for her trade.Great Britain generally shared the advantages of trade agreements with the Empire countries. In the Mody-lees Pact concluded in 1933, " it was agreed that any advantages which might be arranged for British goods should be extended to Indian goods, and that India should participate in any quota which might be allocated to the United Kingdom in markets in which India had no independent quota".(3) The results

(1)"International Currency Experience",League of Nations, 1944. p. 61-64.
(2) Ibid.
(3) Indian Economics Vol II by J.B.Jather & S.G.Beri. p. 537.

of free exchange within the sterling area, Imperial Preference and trade agreements were quite considerable. While in 1929 only 25.7% of the total trade of the British Empire was inter-Empire trade, it rose to 50% in 1939. The sterling area recorded a phenomenal development of trade.(1)

Thus, when in the thirties, the currency warfare of the major economies and its offensive and defensive armaments made international trade almost impossible, the system of currency blocs revealed a new vista of trade and facilitated the trade of the countries concerned considerably. Currency blocs, of course, did not raise the trade to the level it would have attained/under a free multilateral system, but they made possible a volume of trade which would not have been forthcoming under the conditions of the thirties. In the reischmark and dollar areas, the centre-countries exploited the minor economies, though the latter were not net losers, by making the terms of trade more favourable to themselves and unfavourable to minor economies. In the sterling area, however, the centre country allowed itself to be exploited by the minor economies each of which recorded a very significant gain in international trade by their membership of the area. The membership of a currency area was thus the only means open to the minor economies in the thirties to attain a limited measure of the external objective of their monetary policy.

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(1) "The Economic Lessons of the 1930's" by H. W. Arndt. London, 1944. p. 105 and p. 118

SECTION " The External Aspect of Indian Monetaryry Policy in the thirties.

When India decided in September 1931 to de-link her currency, together with sterling, from gold, her balance of payments situation had deteriorated to such an extent that if she had not taken that step at that time, she would, nevertheless, have been forced off the gold standard within a few months. The Indian balance of payments continued to deteriorate even after de-linking and reached its low-water-mark in 1932-33 when its positive merchandise balance sank to a mere three crores.(1) In view of her necessity to pay a heavy foreign debt service, a substantial positive balance was a normal feature of Indian foreign trade. To maintain the servicing of her foreign debts it was absolutely necessary to restore the favourable balance of trade by stepping up exports. Stimulation of exports was all the more necessary for the reason that the bulk of Indian exports consisted of agricultural products on the sale of which depended the minimum of subsistence of millions of her farmers. After suspension of gold payments, several strong forces came into operation which stepped up her exports and restored the balance of payments equilibrium as quickly as it deteriorated before 1931.

The first of these factors that tended to improve India's balance of trade situation was the advantage of a depreciated exchange rate which the rupee had after de-

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(1) "Review of the Trade of India in 1933-34."

linking from gold in 1931. When India de-linked her currency from gold she decided at the same time, to maintain the existing ratio with sterling. Her commercial, financial and banking relations with sterling were so great that maintenance of a stable relation with sterling was vital to her economy and her decision to continue to be a member of the Sterling Area was spontaneous and almost instinctive.(1) As sterling, after de-linking, depreciated in terms of gold to the extent of 30%, the Indian rupee, through its stable sterling rate, enjoyed the same degree of depreciation with non-sterling countries after 1931. The price of Indian exports in the non-sterling markets fell instantaneously to the extent of 30% and this must have maintained or at least arrested the decline of Indian exports. It is not possible to isolate statistically the effect of the depreciated exchange rate but, nevertheless, its effect on the improvement of India's trade situation as well as on balance of payments was undeniable.(2)

The second factor, which worked in the same direction, was a heavy export of gold from 1931 to 1936 - an unprecedented phenomenon in Indian commercial history. India had been

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(1) "Review of the Trade of India in 1931-32" pp.16 and 17.

(2) Percentage share of the U.K. in the exports of India increased from 21 in 1929 to 30 in 1933 and to 32 in 1937 while her share in the imports of India declined from 42 in 1929 to 41 in 1933 and to 32 in 1937.

"International Currency Experience", League of Nations, 1944. p.48.

traditionally a sink for precious metals - import of gold being a normal phenomenon. But the Great Depression put the Indian farmer - particularly the producer of money crops - in a precarious plight. An enquiry made in the Punjab and certain other provinces revealed the fact that it was the dire economic necessity that had forced the farmer to dispose of his gold hoards.(1) There was, anyway, nothing unusual in this. The Indian farmer has always looked upon his gold as the last reserve to fall back upon in difficult times when he habitually mortgaged or pawned it to the local mahajans (money-lenders) but in the past, this pawning of gold did not go to the extent of exporting the metal outside the country. But the depression of the thirties was so severe and the disgorging of gold by the farmer so great that it was beyond the capacity of the gold dealer to keep the whole amount as his stock in trade. Moreover, the depreciation of the sterling and the rupee to the extent of 30% made the value of gold, in terms of rupees, rise to the same extent. While the prices of all other things were falling in terms of rupees, the price of gold was rising. The farmers found the sale of gold to be a substantial help in their dire distress and sold off their hoards. The stocks with the bullionists increased enormously both in quantity and in value and the

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(1) "India's Post War Reconstruction and its International Aspects," by P.S. Lokanathan,
New Delhi, 1946.
pp. 2 and 3.

export of gold began. From 1931 to 1936, gold worth Rs. 282 crores was exported out of India. This gold export helped to improve the balance of payments situation by the full amount of Rs. 282 crores and maintained, to some extent, the level of consumption of the Indian farmer.(1)

The third factor that facilitated Indian exports and thereby improved India's balance of payments situation was the special fall of Indian prices in comparison with prices in other countries which made her exports particularly cheap in the world market. This particular fall of Indian export prices was caused by a combination of several factors. The characteristic of the Great Depression was a special fall in agricultural prices and the market for agricultural goods collapsed more completely than the market for industrial goods. Lowering of agricultural prices necessitated the lowering of the cost of production of agricultural goods. Indian exports consisted mainly of agricultural products and agricultural production in India was extremely inelastic. Apart from climatic fluctuations, the volume of agricultural production remained the same whether prices of agricultural products rose or fell.(2) Agriculturalist's income and wages were the residuary of the sale-proceeds after meeting his out-of-pocket expenses. Due to this reason, the overhead charges of Indian agricultural exports could be reduced to

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(1) "India's Post War Reconstruction and its International Aspects," by P.S. Lokanathan, New Delhi, 1946. pp.2 & 3.

(2) "Economic Problems of Modern India," R.K. Mukerjee, Vol I. London, 1939. pp. 330 - 339.

almost any extent. But in most other countries, cost structure of agricultural goods was not so flexible and ~~xxxxx~~ in most of these latter countries (including even Japan, with very low rates of agricultural income) some income of the farmer constituted a factor of production and did not admit of any indefinite decrease. Probably this was one ofthe reasons why the principal exporters of agricultural products, on the onset of the catastrophic fall of agricultural prices went on accumulating stocks from 1929 till the middle of 1932, when they registered a rise of over 60%.(1) After 1932, there was a slow and gradual reduction in the stocks. This holding back of agricultural products by the principal producers arrested the price-reduction in those countries to some extent. But in India there was no organisation to hold back stocks. Ordinary Indian farmers were too poor to wait for any length of time for their products to be sold. As the entire saleable part of India's products had to be disposed of promptly, she had to maintain her foreign markets at any cost. This necessity for competing and maintaining her sale in the world market led to a special fall in the Indian prices as will appear from the following table.

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(1) "Review of the Trade of India in 1936-37", pp. 2 and 3.

Indices of Wholesale Prices. (1929 = 100)(2)

	1930	1931	1932	1933	1934	1935	1936	1937	1938
U.K.	87.5	76.8	74.9	75.0	77.1	77.9	82.7	95.2	88.8
U.S.A.	90.7	76.6	68.0	69.2	78.6	83.9	84.8	90.6	82.5
Australia.	88.5	79.2	78.3	78.2	81.6	81.5	85.6	91.9	92.2
Japan.	82.4	69.6	73.3	81.6	80.8	84.4	98.9	108.4	114.3
Canada.	90.6	75.4	69.8	70.2	74.9	75.4	73.0	88.4	82.2
India.	82.3	68.1	64.5	61.7	63.1	64.5	64.5	72.3	67.6

Now, this special fall in Indian prices stimulated in turn the exports of India and improved her balance of payments situation to a considerable degree.

The combined favourable effect of all these three factors became visible in the Indian import and export trade as well as in her balance of payments as will be clear from the table below:

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(1) "India's Post War Reconstruction and its International Aspects," by P. S. Lokanathan, New Delhi, 1946: p. 1.

(1)
Balance of Trade of India and Burma (Crores of rupees)

Year	Trade balance	Balance of Treasure	Total visible balance
1929-30	+ 78.98	- 26.20	+ 52.78
1930-31	+ 62.05	- 24.43	+ 37.62
1931-32	+ 34.83	+ 55.65	+ 90.48
1932-33	+ 3.36	+ 64.92	+ 68.28
1933-34	+ 35.67	+ 57.23	+ 92.90
1934-35	+ 23.42	+ 52.54	+ 75.96
1935-36	+ 30.53	+ 36.37	+ 66.90
1936-37	+ 77.77	+ 14.50	+ 92.27
1937-38	+ 43.19	+ 15.12	+ 58.31
1938-39	+ 43.21	+ 12.61	+ 55.82

Thus, the total visible balance of trade from its lowest water-mark in 1930-31 rose the very year India suspended gold payments and stood at 90.48 crores in 1931/32. Balance of payments, therefore, ceased to be a problem for India from that year. Indian foreign trade was no more handicapped from any shortage of foreign means of payment. It was not, therefore, unreasonable to presume that Indian trade would increase and regain its pre-depression level. But, in fact, Indian trade continued to decline for some years more and was much below the 1927-28 level throughout the thirties, as is shown

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(1) "Review of the Trade of India" of the respective years.

by the Indian quantum of trade.

Quantum of Indian Trade: (Base 1927-28 = 100). (1)

Year	Quantum of Exports	Quantum of Imports	Price level of exports	Price level of imports
1927-28	100	100	100	100
1930-31	96.6	82.5	71.5	80
1931-32	82.5	70.6	59.2	71.7
1932-33	74.9	81.4	55.3	65.2
1933-34	86.2	72.7	53.5	63.5
1934-35	87.8	84.1	54.1	63.0
1935-36	88.4	86.6	56.9	62.1
1936-37	107.4	79.8	57.2	62.8
1937-38	103.1	95.7) (2)		
1938-39	102.1	88.7)		

From the above it is apparent that although the quantum exports increased , that of imports lagged far behind and this more than outweighed the increased quantum of exports, so that on the whole there was no increase in the quantum of total trade which stood appreciably below the 1927-28 level. The decline in Indian trade was partly a reflection of the deficiency in the global effective demand (or market) which persisted throughout the thirties and partly due to the excessive virulence with which depression afflicted agriculture exports. The balance of of payments equilibrium attained by India thus kept hidden behind it a heavy loss in her international trade .

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(1) " Review of the Trade of India", 1936-37. p. 28

(2) Ibid. 1939-40. p. 98.

The most important aspect of this loss was a serious deterioration in the terms of Indian foreign trade. As will be apparent in the price-lists of imports and exports in the above table, the former remained higher than the latter throughout the thirties. It meant that the same volume of foreign goods was bought in exchange for a much greater volume of domestic goods. In other words, the terms of trade were very unfavourable to India during the thirties.

In this connection the controversy that was waged in India almost throughout the thirties for a further devaluation of the rupee deserves to be mentioned. It was claimed by most of the Indian economists that a further dose of devaluation would have stimulated both India's foreign trade as well as her internal economic activity.(1) But, as the weight of evidence here indicates, it is extremely doubtful how a further fall in the rupee exchange rate could have attained any of these objectives. Depreciation would have cheapened Indian exports all the more to foreigners. But such lowering of prices could not have increased the sale of Indian goods in countries outside the Sterling Area where exchange-control, import-quota and clearing agreements prevailed and there was a plethora of agricultural products everywhere hanging in every nook and corner of the world market. Within the

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(1) (a) "Minute of Dissent" by Sir P. Thakerdas, paras. 100-152.
"Hilton Young Commission Report 1926"

(b) "Economic Problems of Modern India" by R.K. Mukerjee and H.L. Dey. London. 1941. vol.II. pp.276-308.

Sterling Area, Indian exports were already enjoying the benefits of free and stable exchanges as well as Imperial Preference and a further lowering of prices was unnecessary and would have only made her total sale proceeds smaller. Even if an outside market could absorb a much bigger supply of Indian exports, it was not possible for India appreciably to increase her agricultural exports with an inelastic production, to take advantage of that market. With an inelastic volume of sales, a lower exchange rate of the rupee would have simply meant a smaller earning of foreign exchange and a still higher price of imports. With a smaller volume of foreign means of payment and a higher price of foreign goods the volume of imports would have shrunk and the quantum of Indian foreign trade would have decreased still further.

As regards the stimulation of internal economic activity which in the circumstances of the thirties could only mean industrial production, further devaluation of the rupee could not have made the situation any better. Industrial production during the thirties could be increased only by increasing the purchasing power of the Indian agriculturalists. But a depreciation of the rupee, by reducing the sale-proceeds of the farmers' products would have reduced their income and purchasing power still more. It would have thereby depressed the industries further, rather than stimulating them. There was, therefore, absolutely no case for a further devaluation of the rupee on this ground.

Moreover, the whole contention for devaluation rested on the premise that the rupee was overvalued at 1s. 6d. sterling.

If this were the case, India would have developed an unfavourable balance with Great Britain. In fact, India's exports from a position of equality sharply declined from 1931-32 to 1932-33, while imports slightly increased. But the position of equality between exports and imports was as quickly restored in the following year (1933-34) and this deterioration of exports and balance in 1932-33, related only to trade balance. Including the exports of treasure, India had a highly favourable balance of payments with Great Britain (1) and this positive balance went on increasing every year. This led to an increase of India's sterling earning and one indication of this was a rapid increase of sterling in the central reserves of the country. While the percentage of sterling in her central reserve was 42 in 1931 it went up to 65 in 1934. (2) This increase of her sterling reserve was an indication that the rupee was not overvalued in terms of sterling and therefore could not be the cause of the decline in India's foreign trade.

The cause of the shrinkage in the quantum of India's foreign trade lay elsewhere than in the particular exchange rate of the rupee. The collapse of the world market - and particularly the market for agricultural goods - was the main cause of this decline. The increase in productive activity in the thirties, over and above being inadequate to

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(1) "Review of the Trade of India" 1933-34, pp.139 and 164

(2) "International Currency Experience", League of Nations 1944, p. 57.

restore world-demand to pre-depression level, was effected under the protection of all types of trade restricting devices, such as tariffs, contingents and quotas, exchange controls, etc. and was not, therefore, followed by a commensurate increase in the demand for foreign goods and consequently by a commensurate increase in international trade.(1) Indian trade suffered in consequence of these developments in world trade.

In one direction, however, Indian foreign trade recorded a remarkable increase. While her overall foreign trade was on the decline, her trade within the sterling area expanded throughout the thirties. Though the sterling area was not exactly synonymous with the British Empire, yet it was not very far from it. The trade of the British Empire can be roughly taken as a representative picture of the trade of the sterling area. While in the beginning of the thirties, India's trade with Great Britain and other Empire countries was smaller in volume than her trade with the rest of the world, it became considerably higher during the second half of the decade, as will be clear from the table which follows.

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(1) "Review of the Trade of India", 1936-7. pp. 1 to 16.

India's Trade with Empire and Non-Empire Countries during the Thirties. (1)

(in crores of rupees)

	1931/2	1932/3	1933/4	1934/5	1935/6	1936/7	1937/8	1938/9	1939/40
Empire									
Export	71	62	70	71	76	91	99	90	119
Import	57	59	57	65	65	84	96	88	93
Total	128	121	127	136	141	175	194	178	212
Outside Empire									
Export	90	74	80	84	88	101	90	79	94
Import	69	73	58	67	69	58	79	64	72
Total	159	147	138	151	157	159	169	143	166

Thus, while the percentage of Indian exports to the Empire countries in 1931-2 was only 44, it rose up to 53 in 1938-9, and during the same period, her imports rose from 44.97% to 58.3%. India's exports to the non-Empire countries declined from 56% in 1931-32 to 47% in 1938-39 and her imports from those countries from 55.03% to 41.7%.

The same tendency of increase in India's trade with the Empire countries can be more clearly observed in the development of India's trade with Great Britain during the thirties.

(1) "Review of the Trade of India" of the respective years.

India's Trade with Great Britain (1)

(In crores of rupees)

	1931/2	1932/3	1933/4	1934/5	1935/6	1936/7	1937/8	1938/9	1939/40
Export	45	28	48	49	52	66	64	58	75
Import	45	49	48	54	52	48	52	46	42
Total	90	77	96	103	104	114	116	104	117
Percentage of									
Exports	27.9	28	32.2	31.6	31.5	32.2	33.3	34.1	35.4
Imports	35.5	36.8	41.7	40.6	38.8	38.4	29.9	30.5	25.2

Thus, India's trade with Great Britain not only increased absolutely during the thirties, but while her exports to Great Britain continuously increased, imports from Great Britain almost continuously decreased. While India expanded her market in Great Britain, the latter had her market almost continuously shrunk. The expansion of the Indian market in Great Britain and other Empire countries and the consequential expansion of her trade with them was not only undeniable but considerable.

With a contracting world market and declining world trade it is interesting to enquire about the causes of this phenomenal development of India's trade with Great Britain and other Empire-countries. This increase is generally attributed to the policy of Imperial Preference and the Ottawa Agreement, which came into effect in India from January 1st,

(1) Review of the Trade of India of the respective years.