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VOL. I.

REPORT

OF THE

ROYAL COMMISSION ON INDIAN CURRENCY AND FINANCE.

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CALCUTTA: GOVERNMENT OF INDIA
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1926

THE ROYAL COMMISSION.

GEORGE R.I.

GEORGE THE FIFTH, by the Grace of God, of the United Kingdom of Great Britain and Ireland and of the British Dominions beyond the Seas King, Defender of the Faith, Emperor of India, to

Our Right Trusty and Well-beloved Counsellor EDWARD HILTON YOUNG, Companion of the Distinguished Service Order, upon whom We have conferred the Decoration of the Distinguished Service Cross, Lieutenant-Commander, lately of Our Royal Naval Volunteer Reserve; and

Our Trusty and Well-beloved:—

Sir RAJENDRANATH MOOKERJEE, Knight Commander of Our Most Eminent Order of the Indian Empire, Knight Commander of the Royal Victorian Order;

Sir NORCOT HASTINGS YEELES WARREN, Knight Commander of Our Most Eminent Order of the Indian Empire;

Sir REGINALD ARTHUR MANT, Knight Commander of Our Most Eminent Order of the Indian Empire, Companion of Our Most Exalted Order of the Star of India, Member of the Council of India;

Sir MANECKJI BYRAMJI DADABHOY, Knight Commander of Our Most Eminent Order of the Indian Empire, Member of the Council of State;

Sir HENRY STRAKOSCH, Knight Commander of Our Most Excellent Order of the British Empire;

Sir ALEXANDER ROBERTSON MURRAY, Knight, Companion of Our Most Excellent Order of the British Empire;

Sir PURSHOTAMDAS THAKURDAS, Knight, Companion of Our Most Eminent Order of the Indian Empire, Member of the Legislative Assembly;

JAHANGIR COOVERJEE COYAJEE, Esquire, Professor of Political Economy and Philosophy in the Presidency College at Calcutta; and

WILLIAM EDWARD PRESTON, Esquire:

GREETING!

Whereas We have deemed it expedient that a Commission should forthwith issue to examine and report on the Indian Exchange and currency system and practice, to consider whether any modifications are desirable in the interests of India, and to make recommendations:

Now know ye, that We, reposing great trust and confidence in your knowledge and ability, have authorised and appointed, and do by these Presents authorise and [illegible] you, the said Edward Hilton Young (Chairman); Sir Rajendranath Mookerjee; Sir Norcot Hastings Yeeles Warren; Sir Reginald Arthur Mant; Sir Maneckji Byramji Dadabhoy; Sir Henry Strakosch; Sir Alexander Robertson Murray; Sir Purshotamdas Thakurdas; Jahangir Cooverjee Coyajee and William Edward Preston to be Our Commissioners for the purposes of the said inquiry:

And for the better effecting the purposes of this Our Commission, We do by these Presents give and grant unto you, or any three or more of you, full power, at any place in Our said United Kingdom of Great Britain and Ireland, or in India, to call before you such persons as you shall judge likely to afford you any information upon the subject of this Our Commission; and also, whether in Our said United Kingdom. or in India, to call for information in writing, to call for, have access to and examine all such books, documents, registers and records as may afford you the fullest information on the subject, and to inquire of and concerning the premises by all other lawful ways and means whatsoever:

And We do by these Presents authorise and empower you, or any one or more of you, to visit and personally inspect such places as you may deem it expedient so to inspect for the more effectual carrying out of the purposes aforesaid:

And We do by these Presents will and ordain that this Our Commission shall continue in full force and virtue, and that you, Our said Commissioners, or any three or more of you, may from time to time proceed in the execution thereof, and of every matter and thing therein contained, although the same be not continued from time to time by adjournment:

And We do further ordain that you, or any three or more of you, have liberty to report your proceedings under this Our Commission from time to time, if you shall judge it expedient so to do.

And Our further will and pleasure is that you do, with as little delay as possible, report to Us under your hands and seals, or under the hands and seals of any three or more of you, your opinion upon the matters herein submitted for your consideration.

Given at Our Court at Saint James's the Twenty-fifth day of August, One thousand nine hundred and twenty-five, in the sixteenth year of Our Reign. By His Majesty's Command.

W. Joynson-Hicks.

Royal Commission on Indian Currency and Finance.

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ROYAL COMMISSION ON INDIAN CURRENCY AND FINANCE.

REPORT TO THE KING'S MOST EXCELLENT MAJESTY.

MAY IT PLEASE YOUR MAJESTY,

We, the undersigned Commissioners appointed to examine and report on the Indian exchange and currency system and practice; to consider whether any modifications are desirable in the interests of India; and to make recommendations; humbly submit to Your Majesty the following Report:—

I.—INDIAN CURRENCY SYSTEM.

Historical Retrospect.

1. The history of Indian currency is fully summarised in the Reports of the Herschell, Fowler, and Babington-Smith Committees, and the Chamberlain Commission, and it is brought up to date in the memoranda on the subject prepared by the Secretary to the Government of India in the Finance Department and the Financial Secretary of the India Office which are printed in an appendix* to this Report. The whole narrative need not be repeated here. Our historical retrospect will be confined to a brief review of those facts and events of the past which chiefly influence the present and serve as a guide to the future.

2. Before 1893 India had a mono-metallic system with silver as the standard of value. In order to avoid the embarrassing fluctuations in the rate of exchange with gold standard countries, which were caused by the fall in the price of silver, it was decided in 1893, in accordance with the recommendations of the Herschell Committee, to close the mints to the free coinage of silver. The stoppage of silver coinage was followed by an appreciation of the rupee, and by 1898 it had reached the level of 1*s*. 4*d*. The rupee remained unlimited legal tender, and was the standard of value for all internal transactions.

3. The policy adopted in 1893, by the closing of the mints to the free coinage of silver, had for its declared object the establishment of a gold standard for India, and the Fowler Committee (appointed in 1898) was invited to consider how this object could best be secured. The relevant recommendation of the Committee was as follows:—

> Paragraph 54. "We are in favour of making the British sovereign a legal tender and a current coin in India. We also consider that, at the same time, the Indian Mints should be thrown open to the unrestricted coinage of gold on terms and conditions such as govern the three Australian Branches of the Royal Mint. The result would be that,

* Appendices Nos. 3 and 69.

under identical conditions, the sovereign would be coined and would circulate both at home and in India. Looking forward as we do to the effective establishment in India of a gold standard and currency based on the principles of the free inflow and outflow of gold, we recommend these measures for adoption."

4. This recommendation was accepted by the Secretary of State and the Government of India, and the effective establishment of a gold standard based on a gold currency thus became the recognised object of the Government of India and its advisers. But the Government's first attempt to introduce gold into circulation was not a success, and the Indian Currency system developed in the years that followed along lines different from those foreseen in 1898. Gold never became a substantial part of the circulation. Apart from small change, the internal currency consisted almost entirely of tokens, one printed on silver, the rupee, and the other on paper, the currency note. Their value was maintained at 1*s*. 4*d*. gold (there was during this period no difference between sterling and gold) by the offer of the Secretary of State to sell bills on India without limit of amount at 1*s*. 4⅛*d*. and by the sale of drafts on the Secretary of State on occasions when owing to temporary variations in the currents of trade, exchange tended to fall below the 1*s*. 4*d*. level. The latter process was not, however, the subject of a statutory obligation, nor was it in practice carried out as a matter of course; *e.g.*, the Secretary of State had to be consulted before offers of reverse remittance were announced, and the Government of India never went so far as to undertake to offer sterling drafts in all circumstances. The standard thus evolved was commonly known as a gold exchange standard, although in truth in so far as it amounted to a definite standard at all, it was a standard of sterling exchange. It was in operation at the beginning of the war in 1914.

5. The Chamberlain Commission, which was appointed in 1913 to enquire, among other things, whether the then existing practice in currency matters was conducive to the interests of India, reported *inter alia* as follows:—

> Para. 223.—(iv) "The time has now arrived for a reconsideration of the ultimate goal of the Indian currency system. The belief of the Committee of 1898 was that a gold currency in active circulation is an essential condition of the maintenance of the gold standard in India, but the history of the last 15 years shows that the gold standard has been firmly secured without this condition.
>
> (v) It would not be to India's advantage to encourage an increased use of gold in the internal circulation.

(vi) The people of India neither desire nor need any considerable amount of gold for circulation as currency, and the currency most generally suitable for the internal needs of India consists of rupees and notes.

(vii) A mint for the coinage of gold is not needed for purposes of currency or exchange, but if Indian sentiment genuinely demands it, and the Government of India are prepared to incur the expense, there is no objection in principle to its establishment either from the Indian or from the Imperial standpoint: provided that the coin minted is the sovereign (or the half-sovereign); and it is pre-eminently a question in which Indian sentiment should prevail.

(viii) If a mint for the coinage of gold is not established, refined gold should be received at the Bombay Mint in exchange for currency.

(ix) The Government should continue to aim at giving the people the form of currency which they demand, whether rupees, notes, or gold, but the use of notes should be encouraged.

(x) The essential point is that this internal currency should be supported for exchange purposes by a thoroughly adequate reserve of gold and sterling."

Thus, in effect, the Chamberlain Commission, in its recommendations, abandoned the ideal of a gold standard based on a gold currency, and accepted in its place an exchange standard with an excrescent currency of sovereigns not essential to the working of the system. Owing to the outbreak of the War, no action was taken on these recommendations.

6. The War of 1914-18 put the currency system of India, in common with those of all other countries, to a severe test. The price of silver rose to unprecedented heights, and the material of the silver token became worth more than its face value. The Government found it difficult to continue their unlimited offer of rupees at the long-established rate. There was a keen demand for Indian exports, and there were exceptional disbursements to be made on behalf of the British Government. Internal currency had to be in some way provided, and it could no longer be provided on the old terms. Confronted with these difficulties, the authorities allowed the rupee, so long anchored at 1*s*. 4*d*., to break loose from its moorings and follow the course of silver prices. The rate of exchange accordingly rose rapidly until it reached 2*s*. 4*d*. (sterling) in December, 1919.

7. The Babington-Smith Committee was appointed in May, 1919, when the rate was 1*s*. 8*d*., "to examine the effect of the War on the Indian Exchange and Currency system and practice,

. . . . to consider whether, in the light of this experience and of possible future variations in the price of silver, modifications of system or practice may be required; to make recommendations as to . . . . the policy that should be pursued with a view to meeting the requirements of trade, to maintaining a satisfactory monetary circulation, and to ensuring a stable gold exchange standard." These terms of reference precluded the Committee from considering alternative standards of currency. The Committee accordingly directed its attention to the re-establishment of stability under the then existing exchange standard, a stability which had suddenly been overthrown by the unprecedented rise in the price of silver and by the divorce of sterling from gold. Taking into account the high range of silver prices and the importance of safeguarding the token character of the rupee they recommended the stabilisation of exchange at 2*s*. (gold). They further recommended that during periods of exchange weakness, the Government of India should be authorised to announce, without previous reference to the Secretary of State, their readiness to sell weekly a stated amount of reverse councils.

8. These recommendations were accepted by the Secretary of State. The publication of the Report, in February, 1920, coincided with a keen demand for remittances to London, and steps were at once taken to maintain the new exchange rate of 2*s*. gold recommended by the Committee by the offer of reverse councils at a rate founded on that ratio, allowance being made for the depreciation of sterling in terms of gold, as shown by the dollar-sterling exchange. The rates for reverse councils offered by the Government thus varied from 2*s*. $3\frac{29}{32}$*d*. (sterling) to 2*s*. $10\frac{27}{32}$*d*. (sterling). By the Indian Coinage Amendment Act (Act XXXVI of 1920) the sovereign was made legal tender at Rs. 10. The attempt to hold the rate at 2*s*. gold was not successful; and the Government thereupon tried, with effect from the weekly sale on the 24th June, 1920, to maintain it at 2*s*. sterling. This attempt also failed, and was abandoned on the 28th September. The Government of India at this period were unable to contract currency in India at the pace at which world prices were falling. All they could do was to avoid further inflation and to effect some measure of contraction. This was insufficient to arrest the falling tide of exchange, which early in 1921 fell below the low level of 1*s*. 3*d*. sterling and 1*s*. gold. The 2*s*. ratio, passed in 1920, remained on the statute-book, and was ineffective for purposes of tender of gold to the currency office. By January, 1923, the tide had definitely turned; exchange recovered to 1*s*. 4*d*. sterling, and showed a general tendency to move upward. It reached the level of 1*s*. 6*d*. sterling in October, 1924, at which time it was equivalent to about 1*s*. 4*d*. gold. From that time till March, 1926, the upward tendency of exchange continued, but it was prevented from rising above

1*s*. 6*d*. by free purchases of sterling on the part of Government. Meanwhile sterling was restored to parity with gold about the middle of 1925 and during the 12 months which have since elapsed the rupee has been in the neighbourhood of 1*s*. 6*d*. gold.

9. Such are the salient features in the history of Indian currency to which attention is necessary in order clearly to apprehend the present, and reasonably to plan for the future. Our task is to examine whether any modifications are desirable in the conditions and practice which have come into being as a result of that process of gradual evolution which has been briefly described. For this purpose we must analyse the existing state of affairs both in its economic aspect, which is that of the standard of currency, and in its administrative aspect, which is that of the authority to control the currency. The object of the analysis is to determine the advantages of the existing system and its defects. When its characteristics have thus been distinguished we shall deal with the various remedies that might be applied for the removal of the defects, and we shall explain in full the proposals which we make for that purpose. In a further section of the report we shall deal with the question of the rate at which the rupee should be stabilised.

The Existing System.

10. At the present time Indian currency consists of two kinds of token, paper notes and silver rupees, which are mutually convertible. The paper note is in form a promise by the Government of India to pay to the bearer on demand a specified number of rupees. The rupee is a silver coin 180 grains in weight and eleven-twelfths fine. In addition to these two kinds of token, the sovereign is by statute legal tender for Rs. 10, and the Government is under an obligation to pay Rs. 10, when sovereigns are presented for encashment. As, however, the price of gold is considerably above this parity, the sovereign has disappeared from circulation and is not issued by or tendered to Government.

11. The value of both forms of token currency in relation to sterling is at present being maintained between the gold points corresponding to a gold parity of 1*s*. 6*d*. No obligation has been assumed, but the Government as currency authority have freely purchased sterling when the rate has stood at 1*s*. 6$\frac{3}{16}$*d*., and recently, in April, 1926, authorised the Imperial Bank to make an offer on their behalf to sell sterling at 1*s*. 5$\frac{3}{4}$*d*. The stability of the gold value of the rupee is thus based upon nothing more substantial than a policy of the Government, and at present that policy can be found defined in no notification or undertaking by the Government. It has to be implied from the acts of the Gov-

ernment in relation to the currency, and those acts are subject to no statutory regulation or control.

Reserves.

12. For the purpose of maintaining the value of the token currency, the Government of India hold two reserves—the Paper Currency Reserve and the Gold Standard Reserve. The former is composed of the proceeds of the note issue and is held as a backing against the notes in circulation; the latter has been accumulated from the profits of the coinage of silver rupees and is designed primarily to maintain the external value of those coins. The permanent constitution of the Paper Currency Reserve provides for a holding of gold and silver metallic reserves of not less than 50 per cent. of the total note circulation, and for the balance to be held in rupee and sterling securities. These permanent provisions have not yet become operative, and in the meanwhile the reserve is governed by transitory provisions under which the fiduciary portion is limited to a maximum of 100 crores of rupees, and the balance of the reserve is held in gold and silver coin and bullion. The actual constitution of this reserve on the 30th April, 1926,† was as follows:—

	Rs. Crores.
Silver coin	77·0
Silver bullion	7·7
Gold coin and bullion	22·3*
Rupee securities	57·1
Sterling securities	21·0*
	185·1

The Gold Standard Reserve at present amounts to £40,000,000. It is invested in British Treasury bills and other sterling securities.

Up till April, 1923, the interest on the investments in the Gold Standard Reserve was allocated to the purpose of strengthening the reserves. But since April, 1923, the interest has been credited to the revenues of the Government. Similarly, though the Paper Currency Act of 1920 provided that the interest derived from the securities in the Paper Currency Reserve should be applied to the strengthening of the reserves, this provision has never been put into operation.

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† Throughout the Report, the references to the constitution of the Reserve are based upon the figures of 30th April, 1926. There has been some variation since that date.

* Converted at the statutory rate of 2*s*. per rupee.

Functions of Reserves.

13. There is no clear line of demarcation between the purposes for which the two reserves are respectively utilised, and a certain amount of overlapping is unavoidable owing to the interchangeability of rupees and notes. Thus, though the original function of the Paper Currency Reserve was to provide for the convertibility of notes into rupees, this function became of necessity supplemented by that of maintaining the external value of the notes. On the other hand, while the original function of the Gold Standard Reserve was to maintain the external value of the silver rupee, its use operates to some extent in maintenance of the external value of the notes.

14. The maintenance of the convertibility of the note into silver rupees of the present fineness is only possible so long as the price of silver remains at such a figure that the bullion value of the rupee is not higher than its exchange value: that is, at the existing exchange value, the system would be upset if the price of silver were to rise above 48*d.* per standard ounce.

15. The efficiency of the reserves for the stabilisation of the external value of the rupee depends upon their maintenance at an adequate size, and upon their use in an effective manner. In principle they must be big enough to enable the currency authority to discharge the obligation to sell sterling to any amount required in return for notes and rupees, they must be used for that purpose promptly and without condition, and the sales must be accompanied by an equivalent contraction of domestic currency. In the Indian system these principles have not at all times been clearly recognised, and they are not now, and never have been, adequately supported and enforced by statutory provisions. There is no provision as to any organic relation between the total volume of token currency and the amount of the reserves. So far as the note issue is concerned, the statutes provide for no minimum percentage of gold or sterling securities being held in the reserve as cover against the notes. Nor is there any such fixed relation in regard to the other form of token currency—the silver rupees. The amount of the Gold Standard Reserve and the time and manner of its use are wholly within the discretion of the Government. The Gold Standard Reserve being built out of the profits of coinage, the amount actually carried to the reserve depends on the price at which the silver is purchased and not upon the liabilities outstanding. Any estimate of the amount of the outstanding rupee circulation is largely conjectural; it may be estimated† at 350 to 400 crores, against which the reserve held at present is only $53\frac{1}{3}$ crores.* It is true that a portion of the reserve against the

† As to this estimate, see further para. 123 below.
* Converted at 1*s*. 6*d*. per rupee.

silver rupee is carried in the coin itself (in the shape of its bullion value), but it is admittedly difficult to make any immediate use of the metallic contents of the silver rupees at the time when those rupees are seeking conversion into sterling.

16. The automatic working of the exchange standard is thus not adequately provided for in India, and never has been. The fundamental basis of such a standard is provision for the expansion and contraction of the volume of currency. As the reserve rises or falls with a favourable or an adverse balance of trade, the currency must be automatically expanded or contracted, and the adjustment between internal and world prices maintained. Under the Indian system, contraction is not, and never has been, automatic. On occasions the obligation to buy sterling exchange has been discharged by the Government without any corresponding expansion of domestic currency: the purchases have in the first instance been made against Treasury balances and the currency expansion has been left to be effected subsequently at the discretion of the Government. More serious has been the absence of contraction on occasions when the currency authority has had to sell sterling exchange. The following table (prepared by the Controller of the Currency) shows how far the sales of reverse bills in the past have been accompanied by contraction of currency:—

Years.	*Amount of reverses sold.*	*Rupees received for reverses sold.*	*Amount of contraction effected.*
	£	*Rs. Lakhs.*	*Rs. Lakhs.*
1907-8-9 . .	8,058,000	12,16	12,16
1909-10 . .	156,000	24	*Nil.*
1914-15 . .	8,707,000	13,16	1,05
1915-16 . .	4,893,000	7,38	34
1918-19 . .	5,315,000	7,08	*Nil.*
1919-20-21 . .	55,532,000	47,14	34,68

17. The action of Government in avoiding the full compensatory contraction on these occasions was no doubt due to some extent to fear that the monetary stringency which would have resulted from a full contraction would have dislocated business. There were, moreover, factors at work in 1920—such as revenue deficits and a large amount of maturing debt—which made it then difficult to enforce greater contraction. However that may be, it is clear that on such occasions the exchange standard was not being applied, and possibly could not have been applied, in a normal manner. There was nothing in the Indian system to enforce such an application. In 1920 the consequences were disastrous. There must ever be danger of such disaster under a system which does not automatically enforce contraction of internal currency concurrently with the depletion of Reserves.

Elasticity.

18. In a well-regulated system of currency, the volume of currency should vary freely in response to the varying requirements of trade. In India there is a seasonal variation due to the requirements for financing the movement of crops. In order to provide for them, the currency authority is allowed by statute to issue currency notes up to a maximum limit (at present amounting to Rs. 12 crores) against hundis or internal bills of exchange. This provision has had beneficial effects in practice, but it is not in our opinion incapable of development and improvement in connection with a reorganisation of the bases of Indian currency. Any such provision depends for its proper operation on a plentiful supply of genuine trade bills. But in India, for a variety of reasons, most of the internal trade is financed by a system of cash credits or by the advance of money against demand promissory notes. It has, therefore, been found difficult to secure an adequate volume of bills as cover against the seasonal increase. As a result, the currency authority has on occasions been forced to provide for the needed elasticity by regulating its holding of sterling securities in the Reserve.

19. A well-regulated system should also provide for a measure of elasticity in the expansion of currency in case of great financial crisis, when the need for additional cash for the support of credit is urgent. In such case it is necessary to provide for an emergency issue of currency on special terms. The Indian system makes no express provision of the sort.

Control of Currency and Credit.

20. A description of the present state of affairs and an account of its defects would be incomplete without a reference to the subject of co-ordination of control of currency and credit. India is perhaps the only country, among the great trading countries of the world, in which the Government exercises direct control over currency in general and over the note issue in particular. The banking and currency reserves of the country are thus separated, which diminishes their capacity to effect their specific purpose of stabilisation in the most economical and efficient manner. In other countries this is effected by concentrating these reserves at a Central Bank. Moreover, Government control of currency results in a dual control of monetary policy. The Government controls the currency. The credit situation is controlled, as far as it is controlled at all, by the Imperial Bank. With divided control, there is likelihood of divided counsels and failure to co-ordinate. In fact, difficulties have arisen owing to the existence of two distinct authorities controlling currency and credit. The only certain way to secure co-ordination is to concentrate the controls in one hand. In other countries the single controlling hand is that of a Central Bank.

A Summary.

21. To summarise the present state of affairs and its defects:—

(1) The system is far from simple, and the basis of the stability of the rupee is not readily intelligible to the uninstructed public. The currency consists of two tokens in circulation, with the unnecessary excrescence of a third full-value coin which does not circulate at all. One form of token currency (into which there is an unlimited obligation to convert the other) is highly expensive, and is liable to vanish if the price of silver rises above a certain level.

(2) There is a cumbrous duplication of reserves, with an antiquated, and dangerous, division of responsibility for the control of credit and currency policy.

(3) The system does not secure the automatic expansion and contraction of currency. Such movements are too wholly dependent on the will of the currency authority.

(4) The system is inelastic. The utility of the provision for elasticity made on the recommendation of the Babington-Smith Committee is affected by the methods of financing Indian trade.

Essential Requirements.

22. In consequence of these defects the system has not the confidence of the public. Some of the lack of confidence is the result of an exaggerated idea as to the extent to which any system of currency can be made to work automatically and independently of expert control. But when allowance has been made for all misunderstandings and misapprehensions, the fact remains that a large measure of distrust in the present system is justified by its imperfections. We recognise the skill with which successive generations of officers of Government have developed a system of currency in India, and the fidelity with which they have administered it. From 1898 to 1914 the exchange standard worked on the whole well in practice, except for certain failures of co-ordination due to the division of function between the Government of India and the India Office. But the evolution of the Indian economic system has now reached a stage when her currency can and should be placed upon a more simple, certain, and stable basis. A substantial measure of stability has been attained in the past. But certainty and simplicity have been lacking; and for a system of currency under Indian conditions and for the Indian people these two last qualities are as vitally necessary as the first. Without certainty and simplicity in the system, there will never in India be confidence in the stability of the currency, and without confidence in the stability of the currency, the unistructed public will never be weaned from those uneconomic habits of hoarding and that disinclination to investment which are now the worst obstacles to the progress of the nation.

Alternative Proposals for Reform.

23. After exhaustive inquiry we have found that the possible methods by which the defects in the present system might be remedied may be reduced to three. These are:—

(i) the perfection of the sterling exchange standard,

(ii) the adoption of a gold exchange standard, and

(iii) the adoption of a gold standard proper, with or without a gold currency.

Sterling Exchange Standard.

24. We shall first consider the possibility of a perfected sterling exchange standard. The main defects in the existing system might be remedied by the following provisions:—

(*a*) the Gold Standard Reserve and the Paper Currency Reserve might be amalgamated and reconstituted by statute as a single currency reserve under the control of one currency authority;

(*b*) the currency authority might be required by statute to sell rupees for sterling without limit at the upper gold point of a fixed parity and similarly to sell sterling for rupees at the lower gold point of the same fixed parity.

25. By an appropriate structure built on this foundation, the Indian system might be developed into a perfected sterling exchange standard, both automatic and elastic in its contraction and expansion, and efficient to secure stability. Such a system would involve the least possible holding of metallic reserves, and would also be the most economical from the standpoint of the Indian taxpayer. But the system would have grave defects. The silver currency would still be subject to the threat implied in a rise in the price of silver. Were sterling once more to be divorced from gold, the rupee, being linked to sterling, would suffer a similar divorce. Should sterling become heavily depreciated, Indian prices would have to follow sterling prices to whatever heights the latter might soar or, in the alternative, India would have to absorb some portion of such rise by raising her exchange. India has had experience of both these alternatives and the evils resulting from them are fresh in her memory. We do not indeed regard the possibility of sterling again becoming divorced from gold as of much practical likelihood: it is unlikely to happen except in a world-wide catastrophe that would upset almost all currency systems. Nevertheless there is here a danger to be guarded against, which is real, however remote. There is undoubted disadvantage for India in dependence on the currency of a single country, however stable and firmly linked to gold. For these reasons, were the standard of India to be an exchange standard, it should undoubtedly be a gold exchange standard, and not a sterling exchange standard.

The Gold Exchange Standard.

26. A gold exchange standard could be secured by providing that the currency authority, instead of undertaking to buy and sell sterling, should undertake an obligation to buy and sell, at the upper and lower gold points respectively and to unlimited amounts, the currencies of any of the principal foreign countries with a gold standard.

27. In this case the rupee is not, in theory, directly stabilised in relation to gold. When the obligation is undertaken to buy and sell the currencies of the leading gold standard countries, the value of the rupee may even then vary in relation to gold if the currencies of *all* those countries cease to maintain that relation. In practice, the improbability of such an event is extreme, and on this basis the stability of the rupee in relation to gold would be practically secured.

28. The imposition of a statutory obligation linking the rupee to the currency of more than one gold standard country, together with the other improvements suggested in the preceding paragraphs relating to the sterling exchange standard, would give to India a currency system which would have decided advantages in comparison with the present system. The internal currency would be convertible into international currency at the will of the holders and the rupee would thereby be stabilised; the reserves would be simplified; the parity with gold would be established by statute; and the system would be as automatic as, and no more subject to manipulation than, the systems of the United States of America or Great Britain.

Objections to a Gold Exchange Standard.

29. There would still however be serious defects in the system. The danger would still impend that the silver rupee would vanish as soon as the price of silver rose above the melting point of the coin. Were that to happen, it would be necessary to stop the coinage of the silver rupee of the present fineness and weight and to replace it by small notes and coins of nickel or of less silver content. Under any exchange standard the note is internally convertible into silver rupees only and not into gold, and as long as that is the case, both of the courses referred to are open to such strong objections as to be practically impossible. The status of the rupee must not be adversely affected unless there is something better to take its place.

30. This defect, serious as it is from a technical aspect, is not the only or indeed the chief defect which leads us to the conclusion that a gold exchange standard is not the best for India under present conditions. The chief defect is that although it secures

stability, it has not the simplicity which is essential to secure the confidence of public opinion for any currency system under present conditions in India. The mechanism of an exchange standard is refined. Some knowledge of economics is necessary to understand it. The right of convertibility upon which its stability is based is one of no direct concern to the general public, and it is unintelligible to the majority. The uninstructed see nothing tangible behind the token currency to assure its value. These characteristics, inherent in an exchange standard, make it unsuitable to the needs of a vast community or collection of communities, the various members of which are of all degrees of education, and indeed of all stages of civilisation. It is impossible also to ignore that for historical reasons, into which it is unnecessary to enter, there is a large body of public opinion in India that is suspicious of the mechanism of an exchange standard. It is convinced that this mechanism can be manipulated and it fears that it may be manipulated in a manner inconsistent with Indian interests. We believe ourselves that this fear is groundless, and further, as we have stated already, that a pure exchange standard is no more and no less liable to manipulation than a gold standard; but that is not the opinion of the Indian public, and it is essential that whatever system of currency is adopted should be one that is capable of securing the confidence of Indian public opinion, after experience of its working.

31. The basic right of convertibility that supports an exchange standard is too abstract for the present conditions in India: the backing which it supplies for the token currency is too intangible and invisible. Without some backing more certain, simple, and solid, confidence in the stability of the currency will grow more slowly than it should, if it grows at all, and progress in the habits of banking and investment will be delayed. A backing more certain, simple, and solid must be provided, nor can there be any doubt as to the best means of providing it. In the present state of its development Indian public opinion will have confidence in one thing only as solid enough for a backing for its currency, and that is gold. It requires some link that is real, and not only real but conspicuously visible, between the currency of the country and gold.

32. We are thus led to the conclusion that since a gold exchange standard cannot provide an efficient remedy for the defects of the existing system of Indian currency, to remedy those defects and to fortify popular confidence in the currency it is necessary to establish on a sure basis not only the external, but also the internal, convertibility of the token currency of the country into metallic gold.

A Proposed Scheme for a Gold Currency.

33. We will now consider the principal scheme for a gold standard and gold currency for India that was placed before us in evidence. We refer to the scheme set out in the memoranda and evidence of the officials of the Finance Department of the Government of India.* Under this scheme the silver rupee would cease to be legal tender, except for small amounts, after a period during which it would have been convertible into gold currency. The scheme would involve the attraction to India of a large additional amount of gold, required for currency and the conversion of hoards. It would also involve the sale of an amount of redundant silver equal to about thrice the world's production for a year. A summary of the scheme is contained in an annexe† to this Report.

34. The chief objects of the scheme are:

(*a*) To eliminate the threat to the currency inherent in the possibility of a rise in the price of silver by dethroning the rupee from its position as a standard coin of unlimited legal tender, and thus also to enable the constitution of the reserves to be simplified by eliminating the silver therefrom: and

(*b*) To cure the uneconomic habit of the people of holding the precious metals as a store of value, by assuring them, through the instrumentality of a gold currency, that the same measure which they mete out, in gold value, by way of investment or deposit with a bank, will be meted to them again, in gold value.

Criticism of the Scheme.

35. The points for consideration in connection with this scheme are:

(i) the effect of the absorption by India of about £103 million of gold (in addition to normal absorption for the arts, hoards, etc.) on the supplies of credit, the rates of interest, and gold prices, throughout the world:

(ii) the reliability of the estimates as to the amount of gold to be required and the time at which it would be required and the effect of any miscalculation under these heads on the Indian monetary situation:

(iii) the effect of the scheme on the silver market of the world and the amount which would be realised for the surplus silver:

(iv) the effect of the proposals as to silver on the favourite store of value of the masses of the Indian population:

* Appendices Nos. 5 to 7. † *See* page 90.

(v) the effect on India of the probable reaction of these proposals on other silver-using countries, and especially on China: and

(vi) the possibility of British and American co-operation in the matter of raising credits for the carrying through of the plan.

(i) *Effect of India's additional demand for gold.*

36. As regards the future of the gold market divergent opinions have been expressed, and we have not found it possible to arrive at any definite conclusion as to the future relation between supply and demand. But the evidence which we have received, and in particular that from Professor Gustav Cassel and Mr. Joseph Kitchen, has convinced us that it would be most imprudent not to take into account the possibility, indeed the probability, that unless great economy is exercised in the use of gold, both in regard to its use as a commodity and its use as money, we have to look forward to a prolonged period of steadily falling commodity prices throughout the world.

37. In this connection it is necessary to take account of the requirements of various European and other countries whose financial equilibrium has been disturbed to a greater or less extent in consequence of the War. These countries are now trying to climb back gradually to the gold standard or the gold exchange standard. This aim requires for its fulfilment that there should be a certain amount of free gold available each year. Though signs are not wanting of a spirit of co-operation among the Central Banks towards effecting considerable economies in the international use of gold, there can be no doubt that a large extra demand from India would cause increased competition for gold among the countries of the world and lead to a substantial fall in gold prices and a substantial curtailment of credit. In their reaction on India as one unit in the world's trade system, a fall in gold prices and a curtailment of credit would on balance be unfavourable.

38. It has been suggested that the United States of America at present holds a far larger stock of gold than is required for monetary purposes, and that it would be an advantage to America and to the world generally if some of this redundant gold were to be absorbed by India. The authoritative evidence which we have received from the United States does not confirm this suggestion. We have been told that during last year the United States of America parted with about $134 million of gold, and that the residuum of free gold available is not in excess of the probable requirements of other countries for purposes of reconstruction. Bearing in mind these requirements, and also the internal absorption of gold for the growing needs of the United States itself, we consider that the stock of

"free" gold in America cannot be regarded as superfluous and will probably be absorbed in a comparatively short time.

(ii) *Uncertainty of the estimates of the amount and time of gold demand.*

39. There is an element of uncertainty involved in the estimate of the amount of gold required for giving effect to the scheme, and it is impossible to be sure that the additional demand for gold could be spread over the period of 10 years.

40. Sufficient weight has not been given to the possibility of the replacement, as the result of the scheme, of a part of the note circulation by gold. If a high valued gold coin is introduced, the alternative of carrying a few gold coins would present some attractions and might make people prefer gold coin. In view of India's attitude towards gold, many who have been in the habit of using notes because paper is more convenient than silver rupees might turn to gold, which would be as convenient as rupees and more attractive than notes.

41. Gold coin is fully valued and the metal has a prestige of its own. We anticipate that the decline in the value of silver which would result from the proposals of the scheme relating to that metal would lead to a loss of confidence by the Indian people in the value of silver as a store of savings, and would, to that degree, induce an enlarged absorption of gold for non-monetary purposes, thus augmenting the gold requirements of the scheme.

42. It has been urged that if a gold currency is introduced into circulation, and if exchange is stabilised, the result would be so to increase confidence that gold would come out into circulation or come back into banking reserves from its present location in hoards. This effect might no doubt be produced by a development of banking and investment habits; but there is no very obvious reason why it should be produced by putting gold into circulation. The mere act of putting gold into circulation would not in our opinion develop the banking and investment habit.

43. The scheme involves the reduction of the proportion of gold and sterling securities in the Reserve to gross note circulation, during the transitional period, to 30 per cent. That proportion is in our opinion too low for safety, especially during a period of transition, and the external convertibility of the local currency would be seriously jeopardised if the transition to the new system should coincide with an unusually bad year for Indian exports. An increase in the proportion to a safe level during this period would mean an addition to the estimated gold requirements.

44. It would be imprudent to place much reliance on the anticipation that the initial demand for gold can be limited to Rs. 50 crores. As soon as it became known, and it must become

known at once, that the status of the rupee was threatened, holders would probably hasten to get rid of every rupee they could spare, and it is quite possible that the conversion of the whole amount of surplus rupees might thus have to be effected within a short time after the initiation of the scheme.

45. If the gold requirements should prove to be greater than is contemplated in the scheme, or if the absorption could not be spread over a period of 10 years but progressed more rapidly, the effect would be to intensify the difficulties and to increase the expense of the project. Had the control of the currency meanwhile been transferred to a bank, such an intensification might involve a restriction of credit conditions in a manner and to a degree highly detrimental to the country's economic progress.

(iii) *Effect on the silver market, and possibility of realising the assumed price.*

46. The proposals as to silver involve even more risk than those as to gold and even greater disadvantages. To the extent of about two-thirds of the output, silver is not won for its own sake alone but either as a by-product of base metals or in conjunction with gold. If a substantial fall in the price of silver were to take place, any consequent curtailment of output would hardly affect the base metal product at all, would have more (but still little) influence on the production from gold ores, and would have its chief effect on silver ores only, *i.e.*, on about one-third of the silver production. Even here the effect would be slower and smaller than might at first sight be expected, because the fall in price would not affect the richer mines, and the poorer mines would struggle to continue their production as long as possible. On the other hand, the increasing use of notes, not only in Europe but in the Far East, and the increasing resort to nickel and other base metals for subsidiary coinage, are factors which point to a distinct diminution in the demand for silver in future. The future of the silver market must at all times be a matter shrouded in obscurity: but assuming no change in the status of the silver rupee, the best working hypothesis at present is that the production of silver in the next 10 years will be sufficient to meet the demand. But if, as contemplated in the scheme, silver were to be dethroned from its present position in India, and if for several years India were to meet her own normal demand for silver by melting rupees, we should not be surprised to see silver fall much below the level of 24*d*. assumed in the scheme, specially if, as is not improbable, the action of India had the effect of making other silver using countries follow suit.

47. The Government's policy in regard to gold would also react on the silver position. If the policy of introducing a gold currency were adopted, it would, by largely augmenting the

already extensive demand for a metal that threatens to be in increasingly short supply, result in further depression of the gold price of silver.

(iv) *Effect on silver hoards.*

48. The people of India have from time immemorial placed their trust in silver as the medium of exchange and as their store of value. They are deeply interested in the value of silver bullion, and it is contrary to their interests to depreciate it. The present proposals would inflict heavy losses on the poorer classes, who have put their savings into silver ornaments and who would find their stores of value depreciated by perhaps 50 per cent. by the action of Government. It might well happen that, when it was seen that the price of silver was doomed to fall, there would be a tendency to change over from silver to gold in all parts of the world where silver is still held in large quantities as a store of value. It is proposed, in the scheme, to protect the value of the Indian holdings of silver against this inevitiable depreciation by an import duty. Quite possibly, if it were a very heavy duty, it might protect them to some extent. If it did, it would put the Government of India under a moral obligation to maintain the price of silver for practically all time; for at the completion of the plan they would have sold nearly 700 million ounces of silver to the people at a price that was possibly double the world price. In our opinion, however, the effort to maintain the domestic price of silver irrespective of world price would probably fail. There has always been a considerable trade in silver over the land frontiers of India; and, apart from the difficulties of attempting to exclude a valuable metal from a wide frontier, if people who are accustomed to do that trade were to find that the value of silver in the outside world was very much below the value in India, it would probably affect confidence in the value of silver in India itself. In the case of an article which, like silver, is largely kept as a store of value, the influence of opinion on its value is extremely important.

(v) *Effects on China.*

49. We have thought it desirable to treat separately the effects of these proposals on China. For a very long time the Chinese have been profoundly concerned at the uncertainty of silver as a basis of credit and as a measure of value in China. China is now the only great silver standard country. The countries with which the bulk of her trade is carried on are all either on the gold standard or on the gold exchange standard. The Chinese have for a long time been trying to find some means of substituting gold or some form of gold standard as the basis of their currency. This would probably have been done already but for the expense. The catastrophic fall in the price of silver in terms of gold, which would take place on the bare announcement that surplus silver equal to the world production for three years was

for sale, would undoubtedly tend greatly to accelerate the movement in China, and might induce her immediately to set about securing the gold needed as a basis for instituting some form of gold exchange standard. That would in turn magnify the effect which had already been produced on silver by the Indian announcement, both by the reduction in demand and to some extent by the increased supply of silver that might come into the market. Moreover, the adoption of a gold standard by China would produce a further new demand on the world's gold supplies, and this demand would tend to appreciate gold and thus still further to depress the price of silver.

50. The reaction on Chinese trade would be by no means negligible. China is the greatest, and perhaps the only great, undeveloped market left for the expansion of international trade. The effect of the announcement that the Indian Government proposed selling a large quantity of silver would be immediately to throw out of gear the exchange with China and for a time to paralyse the growing trade of the world with that country. India, apart from her direct trade with China, which is a growing market for cotton and cotton goods, could not escape injury from a wide-spread dislocation of the kind.

(vi) *Raising of the required credits.*

51. As regards the question of credits, we have had the benefit of the opinion and advice of the authorities best qualified to speak on the subject, namely the Governor of the Bank of England and the Governor of the Federal Reserve Bank of New York. This is a matter in which Great Britain would not be able to act alone without the co-operation of America. Both authorities view the proposal with alarm on the grounds that it would retard the progress of monetary reconstruction in Europe, would upset world prices, and would be fundamentally harmful both to India and to the rest of the world. The United States is directly interested in the proposal through its mining industry, both in silver and in base metals. The currency authorities and bankers of the United States, with its great and traditional interest in silver, cannot be expected to support or encourage a proposal which would deal such a blow to the silver market as the addition to supplies of thrice the whole of the world's production for a year. In these circumstances it appears that insuperable difficulties would be encountered in obtaining the necessary credits.

It must be pointed out that, before adopting this proposal, or any other proposal for the introduction of a gold currency into India, the authorities responsible for the scheme must be certain beyond the possibility of doubt that they can carry the scheme successfully through. For that purpose, they must be absolutely assured that they can obtain the amount of gold required. The evidence which we have received prevents any such assurance.

In view of that evidence, we are confident that those responsible for the scheme under consideration would be the first to recognise that the external conditions which are essential for the success of the scheme at the present time are not fulfilled.

Cost of the scheme.

52. Before concluding this section we must refer to the estimates of the cost of the scheme. Mr. Denning puts the cost at 1·65 crores per annum during the first five years and 1·12 crores thereafter. Sir Basil Blackett, by providing for a smaller holding of gold, would reduce the estimate to about two-thirds of a crore after the transitional period. These estimates are based on a proportion of 30 per cent. gold and gold securities in the Reserve during the transition period, a figure which we have already criticized as unsafe. Moreover, these estimates take credit for the income to be derived from the conversion of redundant rupees into interest bearing securities. This income would become available ultimately whether the scheme were adopted or not. Mr. Kisch, after eliminating this credit, considers that, even on the basis of a 30 per cent. proportion, the permanent loss to India as the result of the adoption of the scheme, to which he is strongly opposed, can scarcely fall short of 3 crores a year, besides an indefinite and incalculable amount depending on the extent to which the promotion of a gold circulation checks the future natural growth of the note issue. We have not attempted to recast any of these estimates on an arithmetical basis because we feel that from the nature of the case they must be largely conjectural and would be liable to be greatly exceeded owing to various causes which have been referred to above. All that is certain is that there is expense involved, and that it must be substantial.

Unacceptability of the Scheme.

53. For all these reasons, the scheme fails to commend itself to us. In our opinion both the objects which the scheme has in view can be attained without any of the risks and disadvantages attendant on the scheme itself. Indeed, all that is claimed for it, in comparison with other proposals, is that it would attain the object of educating the Indian people in the habits of banking and investment, and out of the habit of hoarding, more speedily than any other scheme. As already indicated in paragraph 42, we do not think it would do so. The habit of hoarding the precious metals became ingrained in India through centuries of war and rapine, and has persisted under British rule in spite of security of property and the introduction of improved currency and banking facilities. There are welcome signs that the deep-seated habit is beginning to yield to these influences, but we see no reason to believe that the introduction of a gold currency would accelerate the process. Even if it would do so, it seems to us that the acceleration would be gained at the cost of risks far too great

to be justified. We may conjecture that the authors of the scheme would come to the same conclusion, after studying the evidence that we have received from the United States. Sir Basil Blackett comes to meet such a decision when, in the last paragraph of his memorandum, he says: "If the effect of a decision to attempt the change to gold in India is going to be to upset the gold standard in the United States or in Europe, India has clearly nothing to gain by the attempt." In our opinion, the attempt would be very likely to have the consequence to which he refers. It can only be accomplished at the cost of insecurity to those countries which have restored their monetary standards, and at the risk of delay to those countries which are now seeking with reasonable promise to do so, and this uncertainty and delay are likely to produce higher interest rates, business disturbance, and economic depression, with inevitable repercussions on the economic well-being and commercial prosperity of India.

We are unable therefore to recommend this scheme for adoption; and the reasons, stated above, which have led us to this conclusion, would lead us to reject any proposals which involved, by the limitation of the right of legal tender attached to the rupee, or by the sale of any large quantity of silver, any severe shock to the silver market, or which required the abrupt attraction to India by artificial expedients of any large additional amount of gold for circulation as currency.

II.—A GOLD STANDARD FOR INDIA.

54. We have already arrived at the conclusion that, in order to secure public confidence in India, the currency of the country must be linked with gold in a manner that is real and conspicuously visible, or, in other words, that it is necessary to establish a true gold standard. It should be understood that this does not necessarily imply a gold currency. It is possible to have a true gold standard under which the currency is based on gold both in reality and in a manner that is conspicuously visible, without putting gold into circulation. Having stated our reasons for rejecting the principal proposal for a gold standard with a gold currency that has been suggested to us, we proceed to deal with the method for the establishment of the gold standard which we recommend for adoption. The essence of the proposal which we proceed to develop is that the ordinary medium of circulation in India should remain as at present the currency note and the silver rupee, and that the stability of the currency in terms of gold should be secured by making the currency directly convertible into gold for all purposes, but that gold should not circulate as money. It *must* not circulate at first, and it *need* not circulate ever.

Gold in Circulation.

55. The economic reasons against putting gold into circulation are simple and clear. If the gold in the reserve is transferred to

the circulation, the structure of credit that can be built on that reserve is *pro tanto* reduced. The greater the proportion of gold in circulation, the less the elasticity of the currency system. In a system that consists solely of gold coins, there can be no elasticity as the currency can only be increased by taking payment in gold for the balance of exports over imports and it can be decreased by the contrary process only. In short, the less the gold in circulation, the more will be the gold in the reserves and the greater the elasticity of the structure of credit that can be built thereon. Gold in circulation is of uncertain value for the support of exchange. In the words of the Chamberlain Commission's report, "so long as the public have the option of making payments in tokens or in gold, it is the surplus tokens and not the gold in circulation which will seek an outlet at a time of weak exchange."

56. The chief reason that has been advanced for the introduction of a gold currency is that it will give the people confidence in the stability of their currency. We incline to the opinion that the scheme which we outline below will do so much to establish confidence in the stability of the currency that whatever more would be gained in that direction by proceeding to put gold into circulation would not be worth the expense, the loss of elasticity, and the other serious disturbances which are likely to follow. It is agreed by many who advocate the introduction of a gold currency that a token currency of notes inconvertible for internal purposes is the ideal end towards which India should work. The scheme outlined below carries India very far along the road towards that end, and to add to it at some future time a gold currency would seem to us a useless return along a part of the road already taversed by the introduction of this system. It should, moreover, be observed that this scheme has the advantage of setting up almost immediately a full gold standard whereas all other schemes put forward contemplate a postponement of this desirable condition for a decade or more.

57. Nevertheless, it should be recognised that the scheme which we recommend is equally appropriate, whether or not it be held that the gold standard should ultimately be supplemented by a gold currency, at some future time. Supposing that it be held that a gold currency should ultimately be introduced, there is, nevertheless, general agreement that it cannot be introduced at once. (The scheme referred to in paragraph 33 above is that which provides for its most rapid introduction. We have given reasons for believing that the rapidity of that scheme involves risks which ought not to be incurred.) The alternative is to make provision for the gradual strengthening of gold reserves in such a manner as to avoid disturbance to the world's gold and silver markets (with its inevitiable injury to the finances of India and her prosperity in trade), whilst incurring the minimum of expense. The scheme outlined below does contemplate

incidentally a gradual but substantial strengthening of gold reserves, at the maximum rate, and to the maximum extent, possible under present conditions without upsetting prices, incurring excessive expenses, or injuring Indian trade by unduly restricting credit.

It appears to us, in short, that if one desired that a gold currency should be introduced, it is thus that one would have to proceed. Our own view is that it would be unwise to contemplate the introduction of a gold currency under any conditions which we can foresee. But while holding that view, we have tried to see the matter from the point of view of those who do want a gold currency as soon as it can be had. It then appears to us that the following proposals open the door for the introduction of a gold currency at some future time, as wide as it is now possible to open it. They initiate a system which will leave the people of India perfectly free to decide, through their legislature, when that future time has come and a gold currency can be introduced without risk, whether or not they are prepared to confront its expense, and to disregard its other disadvantages. It is quite possible that when that time comes the people of India will no longer wish for a gold currency. The widespread desire for it which was expressed to us by so many witnesses in India appeared to be induced to some extent by the idea that gold was the most advanced form of currency and that other nations had long denied to India a privilege which they enjoyed and highly valued themselves. The war has taught Europe to do without gold coins and experience has aroused doubts of their utility. In returning to a gold standard the nations do not aim at a return to a gold currency. Great Britain has hitherto avoided the reintroduction of gold into circulation. In the United States, gold, which circulates in theory, does not circulate in practice. Some high authorities have expressed the view that the circulation of gold is beginning to be regarded as a sign of a backward civilisation. It may well be that, when India is in a position to introduce gold into circulation, she will reject it as an obsolete ideal, and will finally close the door which we now propose to leave ajar. But that is a matter which we have neither the desire nor the capacity to forejudge.

58. We fully recognise that the system which we recommend will impose upon the Indian currency authority an obligation far more serious than has ever been imposed upon it in the past. The obligation is to convert the currency, not merely into foreign exchange, but into metallic gold, and it is an obligation that is not, as formerly, conditional and circumscribed, but absolute and unlimited. Nevertheless this obligation does not differ in essentials from that which must be undertaken for the maintenance even of a sound exchange standard. It has been undertaken by every other country that has adopted an effective gold standard: and we have satisfied ourselves that the present resources in the form of reserves

at the disposal of the Government of India are adequate to enable the currency authority safely to undertake the obligation, with the measures of fortification, and at the time, which we specify in our detailed recommendations.

The Gold Bullion Standard.

59. The currency system which we recommend for the present needs of India may be described as a gold bullion standard. We propose that an obligation should be imposed by statute on the currency authority to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold is required. The fulfilment by the currency authority of this obligation will secure the stability of the gold value of the rupee, and the stability of exchange within the gold points corresponding to the selected parity. Gold is thus made the standard of value. The rupee is linked to gold and not to sterling or to any other currency or gorup of currencies.

60. Since gold bars are to be given in exchange for notes or silver rupees, not for export only, but for any purpose, this is not an exchange standard; it is an absolute gold standard. Nevertheless the compensatory mechanism of the exchanges is preserved, because gold bars are not currency. When gold bars are given by the currency authority for notes or rupees, the currency is contracted, while, on the other hand, when gold bars are given to the currency authority for notes or rupees, the currency is expanded.

61. For the purposes of India this standard fulfils the essential condition, that it should be not stable only, but simple and certain. It provides the token currency with a right of convertibility that is intelligible to the uninstructed, and with a backing that is tangible and visible. In short, it has the characteristics necessary to inspire confidence in the Indian people, to promote the habits of banking and investment, and to discourage the habit of hoarding precious metals. The statutory obligation to buy and sell gold for rupees without limit at a prescribed parity for the first time in the history of the rupee will base it on gold firmly and in a manner that is conspicuously visible. It establishes the principle that gold is the standard of Indian currency at a fixed ratio, and that the currency authority admits it, and must maintain it.

62. There is no reason to suppose that the obligation to sell gold bars will result in any sudden or substantial drain on the reserves for the conversion of rupee hoards. Holders of such hoards can convert them into gold at present by buying that metal in the open market; and there is good reason to believe that large quantities of hoarded rupees have already been converted in this way. Since it

is not proposed that the rupee should cease to be a legal tender, there will be no greater incentive to convert under the new system than there is now; and as will be observed from the detailed proposals below, it is not intended that gold should be given by the currency authority at a rate cheaper than the market rate.

63. Apart from the economic loss to India, the existence of a large volume of currency in hoards is a formidable obstacle to the efficient working of any currency system. As long as the circulating media of the country, whether silver coin or gold coin or notes, are employed for hoarding, the control of the currency authority over expansion and contraction of currency must be uncertain and there must be a possibility of fluctuation of prices wider than would be the case if all currency served merely the purpose of a medium of exchange. The ebb and flow of currency in hoards with its resultant effects on the volume of active monetary circulation and consequently on prices introduces an element of uncertainty which makes the working of the discount policy by the currency authority very difficult and may stultify its efforts to control the money market. The mere substitution in the hoards of one kind of coin for another, both of which are legal tender, is no remedy at all for this evil. Under the system which we propose, that portion of the hoards which is held in the form of gold coin will be rendered largely innocuous by the step, which we recommend below, of withdrawing the legal tender quality of the sovereign and half-sovereign; while that which is in the form of silver will presumably in course of time, be robbed of its latent power to disturb internal prices and money rates by being replaced—if the process of conversion should continue—by gold bars; or preferably by other more economic forms of saving, such as the gold savings certificates referred to below. Hoards in the form of bars cannot be utilised for monetary purposes until they have been converted into legal tender money, and such addition to the currency can only be made by the currency authority which will, in exceptional circumstances, if the stability of the currency be thereby threatened, be prepared to deal with it through credit control.

Buying and Selling Rates for Gold.

64. A sound gold standard postulates a statutory obligation upon the currency authority to buy and sell gold at a price equivalent to the par value of the monetary unit. This obligation constitutes the cardinal condition and compelling force for the maintenance of monetary stability in relation to gold, and, through gold, in relation to all monetary systems similarly linked to gold or gold exchanges. In the case of India there is a difficulty in the way of imposing on the currency authority an obligation in this simple form. India's demand for gold is not confined to monetary purposes. She has always absorbed gold and will probably continue to

do so in important amounts for purely social uses.. This factor has to be taken into account when determining the obligation of the currency authority to buy and sell gold. At present India's requirements for these purposes are satisfied by an admirably organised bullion market, which buys gold abroad, mainly through the banks, wherever it happens to be cheapest. The gold so bought is sold in India at prices which cover the cost of importing it, and no doubt leave a profit to the dealers. If the currency authority were compelled to sell gold at a price exactly corresponding to the par value of the rupee, it would at once become the cheapest market for gold in India in all ordinary circumstances, for a selling price so determined would take no account of the costs of importation nor of any deviation in the value of the currency from its gold parity. Apart from practically destroying the wholesale bullion market, the currency authority would inevitably become involved in the performance of a task which does not properly belong to it. Its primary duty of maintaining the value of the monetary unit at parity with gold would be made far more difficult, and the means, *e.g.*, the rigorous and continuous contraction of credit, which it would have to employ to attract a steady flow of gold into its reserves, so as to enable it to meet the demand for both monetary and non-monetary gold, would be highly detrimental to the economic progress of the country. It is essential, therefore, that the conditions which are to govern the sale of gold by the currency authority should be so framed as to free it in normal circumstances from the task of supplying gold for non-monetary purposes. In order to achieve this object we propose to fix the selling prices of gold at rates which will enable the Bank to replenish its stock of gold without loss by importation from London. Thus, when exchange is at the upper gold point the selling price for delivery at Bombay will be the par value, *i.e.*, Rs. 21 as. 3 ps. 10 per tola. When exchange is below this point, the Bank will be required to sell gold for delivery in London or Bombay, at the option of the purchaser, at certain notified prices. These prices will be determined by the cost at which gold could be respectively purchased in London or laid down in Bombay from London when exchange is at the lower gold point. The option to the purchaser on the other hand to buy gold for delivery in London at the prices determined leaves the margin between the upper and lower gold points of the exchange as narrow as it could be, having regard to the cost of moving gold to and from its most convenient gold centre. The form in which these obligations would be imposed on the Bank is set out in paragraph 150 below, and the method of computation employed is explained in Schedule 1.

Removal of the Legal Tender Quality of the Sovereign.

65. The obligation to sell gold bars for all purposes makes it impossible to have any gold coin as legal tender, or to mint gold for

the public, unless and until the holding of gold in the reserves is big enough to make it possible to accept the obligations implied in the introduction of a gold currency, and it is decided that the introduction of such a currency is desirable. Otherwise the gold from the reserves might in certain circumstances pass into circulation without effecting any contraction in the currency and thus without fulfilling the essential purpose of securing the compensatory effect of the exchanges.

66. We therefore recommend that the legal tender quality of the sovereign and the half-sovereign should be removed. We do not apprehend any practical inconvenience from this proposal. Although these coins are legal tender under the Coinage Act, they have, owing to the existence of the 2*s*. rate in the statute book, long ceased to function as currency. In this connection it cannot be too clearly emphasised that as the sovereign and half-sovereign are fully valued coins, the cessation of their legal tender character does not involve any diminution in the real value of the coin in the country held as a store of value. In any notification which may be issued, of the buying price for gold, it should be explained that the price announced means so many rupees per full-weight sovereign.

If the currency be firmly stabilised in relation to gold, and be made directly convertible into gold, in accordance with our recommendations, we expect, as said, no undesirable consequences from the demonetisation of the sovereign, nor do we think that there should be any hesitation to sacrifice the shadow of an unnecessary, and in practice little used, gold coin of legal tender, in order to obtain the substance of a real gold standard. For the present, for the reasons stated in earlier passages of this report, a real gold standard with a gold currency is unattainable. The choice is between a real gold standard without a gold currency, and an exchange standard with an excrescent and unnecessary gold currency, which would only serve to disguise from the people of India the true basis of the stability of their currency. As between these two, every advantage in our opinion lies upon the side of the real gold standard that we recommend.

Introduction of Savings Certificates Payable in Gold.

67. The obligation specified in the preceding paragraphs to buy gold bars and to sell them in quantities of not less than 400 ounces, can in the beginning have only an indirect effect upon the people at large in establishing confidence in the currency. It is the bankers and bullion brokers who will make direct use of the provision. It is desirable, therefore, to find some further and more direct and visible means for bringing it home to the masses that gold is the standard of value of the rupee and that the one is convertible into the other. Such a means might, and we recommend that it should, be found in the offer by the Government "on tap" of savings certifi-

cates, redeemable in three or five years, in legal tender money or gold at the option of the holder. They might be issued in denominations of one tola and integral number of tolas, and sold for legal tender money, rupees and notes, at a price which would give the holder an attractive yield in interest. It would add to the attractiveness of the certificates if the holder were given facilities to obtain payment therefor at any time during their currency at a discount reckoned at varying rates according to the date of encashment, but until the date of maturity it would be paid in legal tender currency and not in gold. Thus gold for delivery in three or five years would be sold at a substantial discount in relation to the cash price. As regards the relation between these certificates and the amount of the Reserve, the gold standard, of which this proposal is a useful auxiliary, and which it confirms, does no doubt necessitate a strengthening of the gold holding in the currency reserve, as proposed in paragraph 78 below.

68. The fear has been expressed that these certificates would have the undesirable effect of stimulating in India a fresh demand for gold. For the following reasons we are not of opinion that they would have any such effect. The offer of such certificates should constitute a powerful incentive to investment and a powerful antidote to hoarding. When this certificate matures, the holder of the maturing certificate will receive a striking demonstration of the advantages of investment and of the solidity of the gold basis of the rupee. It is legitimate to hope that the certificates will greatly assist in an ultimate solution of the problem of India's hoards. As soon as it has been established by experience as a certainty that gold is always forthcoming for the certificates on maturity, it is to be expected that there will be a gradual replacement of hoards by certificates. We should thus be achieving the chief benefit that is claimed for a gold currency without any of the risk, expense and inconvenience involved in putting gold into circulation. The benefits to be derived from the carrying out of this proposal need no emphasis. It will attract stores of wealth, great in the aggregate, and at present lying wastefully inert, to their right function of meeting the needs of India for productive capital expenditure.

Convertibility of Notes into Silver Rupees.

69. The termination of the anomalous provision by which one form of note, the paper note, is convertible by law into another form, the silver note, is an essential step in Indian currency reform which must be taken sooner or later. The existence of this obligation has in the past placed, and may conceivably again place, the currency system of the country completely at the mercy of the price of silver. Prudence clearly demands that such a risk, however remote, should be provided against if possible. Moreover, it entails keeping in the

currency reserve, *for purposes of internal convertibility*, a large stock of silver which for external purposes is of little value. When most needed it is liable to prove incapable of realisation. No opportunity for the termination of this obligatory convertibility is likely to be so favourable as the present, when, by making the notes convertible into gold bars for all purposes, a more solid right of convertibility is attached to them than they have ever had since silver ceased to be a reliable standard of value. The obligation must continue in relation to the present currency notes so long as those notes remain in circulation, because the Government's promise to redeem them in rupees must be religiously kept. But we recommend that no legal obligation for conversion into silver rupees should attach to the new notes, the issue of which we propose below. At the same time we think it essential to provide facilities for the free exchange of notes for rupees so long as the people desire to obtain metallic rupees in exchange for them. The people of India have for centuries been habituated to a metallic currency, and to the use of the rupee as a standard coin, and although the one-rupee note has been readily accepted in many parts of the country, notably in the jute districts of Bengal, it would be unwise to attempt to force paper money upon the people against their will. Experience has shown that the best way to foster the use of currency notes is to establish confidence in their practical convertibility, and this confidence has been secured not so much by a legal obligation to encash them at currency offices as by making rupees readily available to the public at centres where there is a demand for them. The public are more concerned with practical facilities of this kind than with legal rights, and if these facilities were withdrawn or seriously curtailed, the growth of the note circulation would probably be checked, and the popularity of the new notes would be endangered. For these reasons we propose to make it incumbent on the currency authority (subject to the reservation indicated in paragraph 135 below) to make rupees and other coin freely available to the public in such quantities as may be required for circulation. Our recommendation implies that the coinage of silver rupees should be stopped for a long time to come, until the amount of silver rupees in circulation is reduced to the amount required for small change.

70. Since there are at present approximately Rs. 85* crores of silver coin and bullion in the reserves and further quantities of rupees may be expected to come out of hoard in due course, a long period must elapse before there is any possibility of the slightest practical difficulty in converting any note that is presented into silver rupees. Practically, therefore, the change in the legal status of the notes should be quite unfelt, and before the present stock of rupees runs low the stabilisation of the rupee in terms of gold will

*See first footnote on page 6.

have had time to establish confidence in the note issue on a basis too firm to be shaken.

71. The removal of the legal obligation to convert notes into silver coin will, we believe, secure the object* which the scheme for the dethronement of the rupee was largely designed to secure. In the first place, it enables silver to be eliminated as a predominant element from the reserves, which are thereby simplified and placed on a sounder basis than they have ever had before. Secondly it prepares the way for getting rid of the threat to the currency inherent in the possibility of a rise in the price of silver. To counter that threat, one must be in a position to replace silver rupees by some cheaper form of currency, and one cannot do so as long as the rupee is one of the bases of convertibility of the note. When no rupees have to be held to secure convertibility of notes, when the public have been made familiar with the use of the one-rupee note as recommended below, and when all forms of internal currency have been firmly based on gold, no insuperable difficulty will arise in meeting the situation should the silver rupee, owing to a rise in the price of silver above the "rupee melting point," disappear from circulation.

Issue of One Rupee Notes.

72. We recommend that the currency authority should, concurrently with the first issue of notes of the new status, re-introduce one-rupee notes, which should be full legal tender and which, like other notes of the new status, should not be convertible by law into silver rupees. In spite of the fact that the issue of one-rupee notes may retard the absorption of the surplus silver rupees now in the Reserve, we consider it worth while incurring such retardation in order to popularise the use of notes, and to prepare the way for dealing with such an emergency as a rise in the price of silver above the melting point of the rupee. The alleged comparative expense of small notes seems a consideration that is negligible in comparison with these advantages. We do not recommend the re-introduction of $2\frac{1}{2}$ rupee notes.

Convertibility of Other Notes into Legal Tender Money.

73. When the present legal right to obtain silver rupees in exchange for notes is withdrawn, it will be necessary to give the public a right to obtain change for the notes in some other form; and we propose to impose a statutory obligation on the currency authority to convert all notes, other than the one-rupee note, on demand into legal tender money, *i.e.*, into notes of smaller

* *See* para. 34 (*a*).

denominations or silver rupees at the option of the currency authority. This statutory provision would in form leave it optional with the currency authority to determine the form of legal tender money to be supplied, but as explained elsewhere we propose to ensure that all reasonable demands of the public for metallic currency shall be met in practice.

74. We are wholly opposed to any alteration in the legal tender character of the silver rupee. The reasons which have been urged for the withdrawal of its legal tender character are overcome, in so far as they are valid, by the above provisions.

Unification of the Paper Currency and the Gold Standard Reserves.

75. Experience has shown that it is impossible to discriminate scientifically between the purposes for which the Paper Currency and Gold Standard Reserves are maintained. As indicated above, the Paper Currency Reserve has to be used in some measure to support exchange and the Gold Standard Reserve has to be used in some measure to secure the external convertibility of the note. But at present the further factor of the legal convertibility of the note into internal currency gives a special character to the Paper Currency Reserve. With the removal of the latter difficulty by our proposals in the preceding paragraphs, the way will be clear for the amalgamation of the two Reserves, a step which will assimilate the Indian system to other currency systems. The combined Reserve will then be simpler and more intelligible to the public, and can be made more efficient in its working.

Composition of the Combined Reserve.

76. We shall discuss our proposals as to the constitution and working of the combined Reserve more fully in a later section of the Report. We shall refer to them here in a generalised form in so far as it is essential to bring out the principles of the proposed system.

77. We propose, in the first place, that the proportions and composition of the combined Reserve should be fixed by statute. This is a provision essential to any currency system in order to secure the automatic expansion and contraction of the currency and the compensatory effect of the exchanges, in accordance with the needs of the country. The lack of any such provision in the case of the Gold Standard Reserve was the chief weakness in the pre-war system and was responsible for its more conspicuous failures.

78. We next propose that it should be laid down that gold and gold securities should form not less than 40 per cent. of the Reserve. In view of the nature and extent of the obligations with regard to the provision of gold which we propose should be

placed on the currency authority, that authority should strive to work to a reserve ratio of from 50 to 60 per cent. In the event of the proposed gold savings certificates proving a popular form of investment, the possible demands for gold by Government for payment of these certificates on maturity would no doubt necessitate a further strengthening of the gold holding in the Reserve, but to what extent experience alone can show. The holding of gold, which now stands at about 12·8 per cent., should be raised to 20 *per cent.* as soon as possible, and in any case in not more than 5 years, and to 25 per cent. in 10 years, with a minimum of Rs. 30 crores from the outset. This would give a minimum of about Rs. 60 crores after 10 years on the basis of the present circulation. During this period no favourable opportunity of fortifying the gold holding in the Reserve should be allowed to escape.

79. This fortification of the Reserve is needed to secure confidence in the note in view of the new obligations proposed in paragraph 59 above and the new status of the note proposed in paragraph 141. It should be made in any case, whether or not it be held that the scheme now proposed should ultimately be supplemented by a gold currency. Even if it be held that there should ultimately be a gold currency, these provisions ensure that a beginning be made with the accumulation of an additional gold holding with the minimum of risk and expense and in such a manner as to cause the least possible disturbance to the world's gold and silver markets, with their inevitable repercussions on India and on the finances of India.

80. Silver reserves are ordinarily out of place in a gold standard system. But in India, silver coin forms a large proportion of the total circulation. There is a seasonal ebb-and-flow of considerable dimensions in this form of currency, and it is necessary to hold a considerable quantity of rupees in the Reserve to meet genuine demands for purposes of circulation. With the growing use of one-rupee notes these demands will, we hope, be reduced. In any case the present stock of rupees is unduly large. We therefore make a recommendation (paragraph 145 below), which will have the effect of ensuring the gradual reduction of the silver holding in the Reserve, during a transitional period of 10 years, from the present figure of Rs. 85* crores to Rs. 25 crores, on the basis of the present circulation.

81. We recommend that the balance of the Reserve be held in Government of India rupee securities and self-liquidating trade bills. For reasons which will be explained later, it is desirable to limit the holding of Government of India rupee securities to 25 per cent. of the Reserve, or Rs. 50 crores, whichever is less.

82. The new Reserve will have to maintain the external convertibility of a circulation which includes both paper and silver

* See first footnote on page 6.

tokens. As regards the former, the liability will, of course, be equal to the total outstanding note circulation. But in the case of the silver rupee such a cent. per cent. backing is neither possible nor desirable. There is obviously an irreducible minimum below which the rupee circulation cannot fall, if the business of the country is to be carried on. Moreover, even of that portion of the silver circulation which is potentially contractible only the difference between the face value and the realisable bullion value need be covered. Any estimate on such a subject must be largely conjectural and subject to variations in the price and marketability of silver. We have fixed a more or less arbitrary figure of Rs. 50 crores as the assumed liability of the Reserve in respect of the contractibility of the rupee circulation.

III.—A CENTRAL BANK FOR INDIA.

83. So far we have dealt with the standard of currency. We now proceed to deal with the question of the authority who should control the working of that standard.

The evidence has clearly brought out the inherent weakness of a system in which the control of currency and of credit is in the hands of two distinct authorities whose policies may be widely divergent, and in which the currency and banking reserves are controlled and managed separately one from the other. It has brought out the necessity of a unity of policy in the control of currency and credit in a modern financial organisation, if monetary stability is to be achieved. What has less clearly emerged from the evidence but none the less needs emphasis is how essential it is for the development of banking generally that the foundations of the credit organisation should be truly laid. This will only be the case if the commercial banks (a phrase in which are included both exchange and indigenous banks) are able, when the necessity arises, to turn into cash a maximum of their assets with a minimum of disturbance to general conditions. It is only through the establishment of a central banking system, with the facilities of rediscounting it affords, that this end can be achieved. Not until then does the commercial banks' most legitimate asset, *viz.*, a short-term advance against goods in the form of a commercial bill, become a quick asset capable of prompt realisation in times of stress. The system, in fact, enables the commercial banks to regard their holdings of commercial bills as their secondary reserves.

84. The economic history of the great trading nations of the world during the last half-century demonstrates, far more clearly than any technical exposition of the workings of the system could demonstrate, the high efficiency of the system and its benign influence upon economic progress, wherever it has been introduced.

The United States of America has been one of the last to adopt it. It has done so under the stress of its disastrous experience of regularly and frequently recurring financial upheavals of gigantic proportions, directly traceable to the weakness of the system of decentralised banking and currency reserves. There are not a few students of financial affairs who hold that, if it had not been for the timely introduction of the Federal Reserve System in 1913, it is doubtful whether America, in spite of its enormous economic advantages, could have weathered the stress of the great war without grievous harm to its financial structure.

85. The Central Banks in other countries work under charters which, though differing in detail, are very similar as regards their fundamental lines. In general they are entrusted with the sole right of note issue and the responsibility of maintaining the stability of the currency. They are the custodians of the currency and banking reserves and of the cash balances of their Governments. Their business, in the main, is confined to that of a bank of the banks and of the Government. These functions of necessity require that the character of their business should be of the soundest. Such limitations upon their business prevent these Central Banks from transacting the every-day commercial banking business of the country or from entering into competition with the commercial banks in any general sense. But, in times of stress, they intervene vigorously in the country's business by extending credit facilities liberally. They are primarily concerned with upholding the credit of the country and guiding its financial policy.

We are of opinion that India, profiting by the experience of other nations, should perfect her currency and credit organisation by setting up a Central Bank with a charter framed on lines which experience has proved to be sound.

86. Before dealing with the technical questions of the Indian charter, it is necessary to consider who is to be entrusted with it. Should it be the Imperial Bank (which is now performing at any rate one or two of the functions of a Central Bank) or should it be a wholly new institution? The idea of utilising the existing organisation of the Imperial Bank is tempting at first sight, but on close consideration it will be found that, whatever advantages there may be in this course, the disadvantages outweigh them.

87. If the Imperial Bank were required to discharge the duties of a true Central Bank its charter would have to be amended radically in the direction indicated. It would thus be precluded from undertaking a great many tasks which it now successfully performs as a commercial bank. The country would then lose the benefit of the elaborate and widespread organisation which

has been set up, through the length and breadth of India, to make available to the community the increased commercial banking facilities, which are so urgently needed, and to assist in fostering, among the people as a whole, the habit of banking and investment. This consideration alone negatives the idea of disturbing the present functions of the Imperial Bank. It suggests, on the contrary, that that bank should be freed altogether from the restrictions which its present charter imposes upon it, and which clearly have their origin in the hybrid character of the functions which were originally assigned to it. When those of a purely central banking character are taken over—as they should be—by the new Central Bank, there is no longer any reason why the Imperial Bank should not be as free and unencumbered in its sphere of activity as any other of the commercial banks. Its important task of giving India the widespread banking facilities which it needs will thereby be facilitated. It may perhaps be apprehended that with the creation of the Central Bank the Imperial Bank will lose some of the prestige which at present attaches to it as the sole banker of the Government. But there are numerous ways in which its interests and its ability to continue its present policy of the extension of branch banking may be safeguarded. We can see no reason to doubt that the Imperial Bank could come to a satisfactory agreement with the new Central Bank whereby the latter would employ the former as its agents in the *mofussil* and, in consideration of this service, place at the disposal of the Imperial Bank such funds and for such periods as would be required to enable the Imperial Bank's branches to become self-supporting.

88. A middle course which has been suggested, and which has for its object a gradual process of what may be termed "decommercialisation" of the Imperial Bank, is equally unattractive. The proposal is to confine the Bank's functions to those of a true Central Bank in the centres where adequate commercial banking facilities exist, and to permit it to do the ordinary commercial banking business in all those localities where, apart from the Imperal Bank, there is no other reputable bank established. It is proposed that only when in these localities one or two commercial banks have opened their establishments should be business of the Imperial Bank's branch be restricted to that of a Central Bank. This proposal suffers in the main from the same disadvantage that attaches to an immediate and complete conversion of the Imperial Bank into a Central Bank. Under it the Imperial Bank would be eliminated from the field of commercial banking in all the important centres (such as Bombay, Calcutta, Madras, etc.), and the wholesome competition it provides would thus be lost, while its hybrid character would be likely to weaken its functions both as a Central Bank in the important centres and as a commercial bank in the smaller centres.

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89. We come, therefore, to the conclusion that the proper course to take is to entrust the central banking functions to a new organisation endowed with a charter which wholly conforms to the requirements of a true Central Bank. That new bank would no doubt take over from the Imperial Bank such part of its organisation and staff as under the new order of things may become redundant to the purposes of the Imperial Bank, and from the Government a number of officials whose experience in the management of the currency would be of particular help to the new Central Bank.

90. The future relations between the Government of India, the Central Bank, and the Imperial Bank, must be matters for negotiation between the parties concerned, and for that reason we refrain from making detailed recommendations under this heading. We desire however to state that in our opinion those negotiations, and the relations which they establish, should recognise the principle that there is work to be done in developing banking facilities, so essential in the interests of the Indian people, which the Imperial bank has been doing, and can continue to do so long only as it receives some measure of official countenance and support. The banking organisation which India requires must be based, not upon a Central Bank alone as elsewhere, but upon a Central Bank, and a great commercial bank which has government countenance to inspire confidence in it amongst an uninstructed public, and whatever government assistance is needed to enable it to perform the function of the initiator of banking facilities. As to the extent of that assistance, we content ourselves with the observation that it should be designed to enable the Imperial Bank to maintain and develop its essential work of the provision of new branches.

The Capital of the Central Bank.

91. There is no need, nor is it in fact desirable, that a Central Bank should be endowed with any very great amount of capital. It is natural that those in charge of the Bank's affairs should desire to give to the shareholders as good a return as possible. The greater the capital, the greater must the profits be in order to produce a given return, and the greater therefore the incentive for the management to do business which it might be better to avoid. Moreover, we propose in a later paragraph that the Government should be entitled to a share of the profits of the Bank after a fixed preferred dividend has been allocated to the shareholders. If the capital of the Bank should be larger than is really required—and in the present state of development of the Indian rediscount market, the capital which is required for the business of the new Bank at the outset cannot be very large—the profit which accrues to Government would be considerably reduced on account of the preferred dividend on non-earning capital. Again,

while it would be possible to increase the capital later if found necessary, it would be somewhat difficult to reduce it. Taking these considerations into account, we are of opinion that a fully paid up capital of Rs. 5 crores would be sufficient, allowing even for a material expansion of banking in India.

The Imperial Bank will be called upon to give up to the new Central Bank some of the privileges it now enjoys. It is right, therefore, that the Imperial Bank's shareholders should be given the first opportunity of subscribing for the capital stock of the Central Bank. This is a valuable concession, for experience shows that the business of central banking is a profitable one, and that central bank stocked in other countries usually ranks as high in the estimation of investors as Government securities.

The Name of the Bank.

92. This is largely a matter of taste and local psychology. After considering various alternatives, we suggest that the new bank be called the "Reserve Bank of India."

Board and Management.

93. The difficult problem of co-ordinating the management of a banking organisation with important establishments widely separated and with business widely differing in character in the various parts of the country, seems to have been solved by the Imperial Bank of India. The system of local head offices in the chief business centres, managed by Local Boards who are elected by the shareholders registered in the respective branch registers, appears to us to be as appropriate to the organisation of the Reserve Bank as it is to that of the Imperial Bank. The provisions of sections 23, 24, 25 and 26 of the Imperial Bank of India Act, 1920, should therefore be embodied in the charter of the Reserve Bank. The provisions regarding the election of members of Local Boards, etc., as embodied in regulations 43 to 48 inclusive, should similarly be followed, except in one respect. The term of office of the Presidents and Vice-Presidents of Local Boards, which, under the Imperial Bank Act, is fixed at one year, is too short to conduce to efficient work. We therefore recommend that the period be extended to two years, and that the limitation contained in regulation 44 (1), that no person shall be chosen to be President or Vice-President twice in succession, should be omitted.

94. Resolutions passed both by the International Financial Conference of Brussels (1920) and that of Genoa (1922) recommend, in identical terms, that "Banks, and especially Banks of Issue, should be free from political pressure, and should be conducted solely on lines of prudent finance." In the spirit of these resolutions, care should be taken to assure that a predominant

majority of members of the Local as well as the Central Boards of the Bank should derive their mandate from the shareholders of the Bank by election, and that only a small minority of the Board should be nominated by Government. It has been sometimes urged that all members of the Board of a Central Bank of Issue should derive their mandate solely from the shareholders, none being nominated by the Government, but we consider that, in the particular circumstances of India, *viz.*, the wide experience of the Government in the management of the currency and the great importance of the Government's banking and remittance business, it would not merely be appropriate but desirable that the Government should nominate a small minority of members on the Central Board, the members of the Local Boards being, as hitherto, elected solely by shareholders of the respective branch registers. We accordingly propose that the new charter should provide for the Central Board to be constituted as follows:—

(*a*) The Presidents and Vice-Presidents of the Local Boards established by the Act. In addition, each Local Board to select from among its members, by a majority vote, one member to serve on the Central Board for two years.

(*b*) A Managing Governor and a Deputy Managing Governor, who shall be persons of appropriate experience, and who shall devote their whole time to the affairs of the Bank, to be appointed by the Governor-General in Council for a period of five years, on salaries and allowances to be determined by the Central Board.

(*c*) Such number of persons, not exceeding three, and not being officers of the Government, as may be nominated by the Governor-General in Council. Such persons shall hold office for one year, but may be re-nominated.

The Central Board would thus be composed of 14 members, of whom nine would be elected by shareholders, a maximum of three would be nominated by the Governor-General in Council, and a Managing Governor and Deputy Managing Governor would also be nominated by the Governor-General in Council In addition to the above 14 members, the Government should be entitled to nominate an official member to the Board who should have the right and duty to attend and advise the Board but not to vote.

Such a constitution will leave the Reserve Bank free from interference from the Executive in the day to day conduct of its business and in banking policy, a condition which we consider of paramount importance. At the same time, the Government, through its representative on the Central Board, will be kept closely in touch with the Bank, and there will be the mutual advantage of close co-ordination between the currency and credit policy and the financial policy of the country.

Sections 29 and 30 of the Imperial Bank Act should be embodied in the new charter.

95. To eliminate the danger of political pressure being exercised upon the Boards of the Reserve Bank, it is desirable to introduce a provision in its charter directing that no person shall be appointed President or Vice-President of a Local Board, or shall be nominated as a member of the Central Board, if he is a member of the Governor-General's Council, the Council of State, the Legislative Assembly, or of any of the Provincial Governments or Legislative Councils.

96. The Reserve Bank's principal function being to rediscount bankable bills held by the commercial banks, it is desirable that the Boards of the Reserve Bank should exercise their unfettered discretion in accepting or rejecting such paper, and it is therefore undesirable that representatives of any of the commercial banks should hold the position of President, Vice-President or member of a Local Board or that of member of the Central Board. A provision to this effect should be embodied in the charter.

Head Office.

97. The Head Office of the Bank should be established in Bombay, and the meetings of the Central Board should ordinarily be held there.

Votes of Shareholders at General Meetings.

98. Care must be taken to ensure that the policy of the Reserve Bank is governed by purely national considerations, and is not influenced by the interests of any individual section of the community. It is undesirable that it should be possible for any particular group to acquire control of the affairs of the Bank and impose its policy upon the country. It is imperative, therefore, to limit the number of votes which each shareholder is entitled to exercise, whatever his shareholding may be. Accordingly, a provision should be introduced into the charter that shareholders shall have one vote for every four shares (assuming that the shares are of Rs. 500), of which they have been the registered holders for not less than six months, no shareholder; however, being entitled to have more than a total of ten votes, whether in his own name or as proxy.

The discretion which would be vested in the Local Boards (under the provision corresponding to section 26 of the Imperial Bank of India Act), to approve or refuse to approve transfers of shares, would also be exercised when necessary with a view to preventing the multiplication of individuals' voting power by transfer to nominees.

Division of Profits.

99. The business of a Central Bank should not be run mainly for profit. Dividends should be limited to a reasonable return on its capital, adequate provision being made for building up substantial reserves, especially in the earlier years. Limitation of the dividend must also be considered in connection with the question how the Government of India is to be compensated for handing over to the Reserve Bank the assets of the Paper Currency and Gold Standard Reserves, and the profits arising from the right of note issue. The simplest and most convenient way in which the Government could be compensated is by allocating to it certain of the surplus profits of the Bank above a limited dividend. We recommend that a plan of dividing profits in the following manner be adopted.

100. After making provision for bad and doubtful debts, depreciation in assets, and all such items as are usually provided for by bankers, and after payment out of the net profits of a cumulative dividend at the rate of five* per cent. per annum on the paid-up capital, there should be allocated to the reserve fund, until such reserve fund is equal to 25 per cent. of the paid-up capital, three-quarters of the surplus, and one-quarter to the Government. Thereafter until the reserve fund is equal to the paid-up capital of the Bank, one-half of the surplus should be allocated to the reserve fund and the other half to the Government. When the reserve fund is equal to the paid-up capital of the Bank, one-eighth of the surplus, but not exceeding three* per cent. of the paid-up capital, should be paid to the shareholders, and the balance to the Government.

We must here anticipate an objection that may be raised against the above scheme, namely, that it is proposed to build up the reserve too rapidly, and at the expense of the "profits" which under the existing system would go to the taxpayer's relief. The present practice under which the profit from the Reserves is not available for the portification of the Reserves is not in our opinion a sound one. But, even looking at the question from the standpoint of political expediency, we do not consider that our proposal would involve a fresh burden on the taxpayer. The maximum diversion of Government revenue to the accumulation of the reserve is only Rs. 5 crores, and this should in our opinion be set against the resources which would be placed at the disposal of Government as a consequence of the amalgamation of the Gold Standard Reserve and the Paper Currency Reserve (*vide* paragraph 145 below), and which even if not immediately realised could no doubt be brought to the credit of revenue in the earlier

* These figures are quoted illustratively, and are subject to alteration in view of market conditions.

years, when the profits handed over by the Bank were not yet equal to those at present accruing from the Reserves. Strongly as we feel that the new Bank's reserves should be built up as rapidly as possible, we should not have recommended a fortification of the reserves at the rate proposed had we not been confident that it could be achieved without any fresh taxation or postponement of remissions of taxation.

Increase of Capital of the Bank.

101. The Capital of the Bank might be increased by the Central Board from time to time with the approval of the Governor-General in Council, and the price at which shares might be issued for that purpose should be determined by the Central Board with the approval of the Governor-General in Council.

Business of the Bank.

102. In a separate schedule (Schedule II) attached to this Report we have drawn up a list of the business which the Bank might do and that which it might not do, and we recommend that it be embodied in the charter. The list has been drawn up on the basis of two principles, *viz.*, that the Bank should be a true Central Bank and that its functions and capacities should be so organised as to secure that it should be made use of without suspicion or jealousy as the Bankers' Bank. We have advisedly made no provision in that schedule for the Reserve Bank having recourse to direct operations in the bill market; not that such a provision is unnecesasry—we regard it as a cardinal provision in the charter of a true Central Bank if it is properly to discharge its primary duty of regulating credit and maintaining the stability of the currency; but in the present state of development of the bill market in India, we do not consider that open market operations by the Reserve Bank are an indispensable method for carrying out its credit policy. Rather we think that this development should follow in the wake of banking progress and the growth of a large and healthy bill market. Experience in other countries shows that with the creation of a Central Bank, and the consequential development of a sound banking system, the bill market comes into being in a surprisingly short time. In India, where the hundi or internal bill of exchange has been in existence for many years, we hope the growth of the habit of drawing bills instead of opening cash credits will be more rapid than elsewhere. In order to provide for such future development, the charter should enable the Reserve Bank to apply to the Governor-General in Council for power to buy and sell in the market bills of exchange, promissory notes or other commercial paper arising out of *bonâ fide* commercial or trade transactions bearing two or more good signatures and having a maturity not exceeding 90 days, if and when it finds such powers necessary to the performance of its function of regulating the supply

of credit. In deciding whether to grant or refuse this application, the Governor-General in Council would of course give due consideration to the possible effect, on the various classes of persons concerned, of the operation of the proposed new procedure. To avoid ambiguity, we should state that our proposal is that this power, if and when granted, should be granted once and for all; not that it should have to be applied for on each occasion.

Remittances for Financing the Home Treasury.

103. We recommend that the Reserve Bank should be entrusted with all the remittance operations of the Government in India and in London. The Government will thus cease directly to operate in the exchange market.

Such an arrangement is the natural consequence of the establishment of a Central Bank of issue. The business of remittance is essentially banking business. Since the bank of issue must be the bank of the Government in other matters, it is convenient and, as will be seen, essential that it should be so in this matter also; and it may be assumed that it will be able to transact the business at least as economically as the Government. Further, an obligation is imposed upon the Bank to maintain the value of the currency. The annual remittance on Government account amounts to some £35 millions, a large sum in proportion to the total foreign remittance business of the country. The time and method of making these remittances have an intimate connection* with the Bank's discharge of its obligations. It would be difficult, if not impossible, for the Bank to discharge its esesntial obligation to the currency unless it conducted the remittance business of the Government.

104. On the other hand, it has been suggested that the Reserve Bank, through its exclusive knowledge of its own bank rate policy, would, if allowed to deal in the exchange market, be placed in a position of undue advantage as compared with other banks and firms. Such an objection might perhaps legitimately be made if it were proposed to hand over the control of the currency, and the conduct of Government remittance, to a bank competing with other banks for ordinary commercial business. But it is misconceived, made in relation to a transfer to such a Bank as we propose. In that institution the other banks of the country will find, not a state-aided competitor, but a coadjutor and a potential source of support. The exchange operations of the Bank will normally be limited to the *bonâ fide* requirements of its customers (including the actual requirements of the Secretary of State) and

* The action of the Government by which in recent years part of the remittance first put through the treasury was subsequently put through currency, shows that the Government cannot carry on its remittance operations irrespective of their effect on the Indian money market or on currency policy.

to its necessary operations through and on account of the Reserve. We may point out that such operations may be necessary to the discharge of the responsibilities of the Bank, not only in the routine course of business, but in order to enable it to co-operate with other central banks in those joint measures which are increasingly necessary for the proper co-ordination of monetary policies. There is, therefore, no reason to suppose that its operations will be in any way to the disadvantage of the market.

105. It has been suggested that the Secretary of State has constitutional and statutory responsibilities to Parliament (including the particular responsibility to the holders of India sterling debt) which make it impossible for him to be satisfied with an obligation undertaken by a bank, however pre-eminent in status, to keep him supplied with funds. We are, however, unable to find that the duties and responsibilities laid upon the Secretary of State in relation to financial commitments in the United Kingdom are different in kind or extent from those laid upon him in relation to financial commitments in India, which are similarly incurred in his name. The latter are already discharged on his behalf by the Government of India, and are to some extent discharged through the agency of the Imperial Bank. If the Secretary of State is able to entrust to duly authorised agents the carrying out of his debt and remittance obligations in India, he may be satisfied similarly to employ an agent to keep him in funds for the implementing of his obligations in the United Kingdom. The employment of an agent does not imply the abrogation of the ultimate control and responsibility vested in the Secretary of State. Should the agent not discharge the obligations which it has accepted, the power of the Secretary of State himself to discharge his own obligations is in no way qualified or diminished.

106. When arrangements have been made for the transfer of the conduct of Government remittance to the Reserve Bank, it will be necessary for the successful discharge of that function that the Secretary of State should furnish to the Bank in advance, through the Government of India, periodical information as to his requirements. It has been suggested in evidence that it would not be possible to forecast with accuracy the requirements for any considerable length of time ahead. Occasions may obviously arise when unexpected commitments, or increases of existing commitments, may materialise on a large scale. Any scheme must provide for meeting such a contingency, which would no doubt be of rare occurrence. But a great part of the Secretary of State's commitments are in respect of payments which are regularly recurring, or at least easily foreseeable; and it should not as a rule be difficult to produce reasonably accurate forecasts of the funds required. As regards minor variations between estimates and actuals no difficulty is likely to arise. It is not, of course, suggested that it should be laid down that estimates once furnished must be rigidly

adhered to. The Bank would be primarily responsible for the programme of remittance, after giving due regard to the views of the Government of India. The Secretary of State will no doubt retain a working balance sufficient to ensure his having funds available to meet any ordinary and foreseeable excess of actual over expected exenditure.

107. The question by what methods the Government remittances to London should be made has in recent times occupied a prominent place in all discussions of the Indian currency system. With the creation of the Reserve Bank, the transfer to it of the remittance business, and the withdrawal of Government from active operations in the exchange market, the significance of these questions will be greatly reduced. If the Bank is given the right and duty of conducting the official remittance business, as part of its larger function of managing the currency and credit system as a whole, it should clearly be left free, at its discretion, to employ such method or methods as it may find most convenient and conducive to the smooth running of the machine. Under the new conditions experience will soon teach—while nothing else can teach—by what methods the interests, commercial and financial, of the country can best be served.

108. We observe that the method of remittance by the purchase of sterling in the market in India, instead of the sale of council bills in London, has recently been introduced with advantage. We have received much evidence as to the respective merits of private purchase of sterling and of public tender. The main objections urged against the former system are that it involves undesirable secrecy and the possibility of favouritism, and against the latter that it is conducted by the Secretary of State in London. With regard to the latter objection, we are of opinion that the method of public tender could be employed in India with almost as much practical facility as it has been applied in London and with equal convenience to the commercial public. As regards the former, we recognise that there is some force in the objections under present conditions, but these will cease to have any weight when once the system proposed under our plan has been introduced and the obligation placed upon the Bank to buy and sell gold at the prescribed prices. Beyond these observations we do not desire to go in the direction of prescribing or limiting the methods of remittance to be employed by the Bank. To fetter its discretion in advance must be to waste the lessons of experience.

109. It is to be observed that the exchange operations of the Bank, although effected in large measure to meet the requirements of the Government, will not be the operations of the Government. The question, therefore, of publicity does not arise in connection with these operations, as it arises in the case of the exchange operations conducted directly by the Government. We consider

that the occasional suspicion attached to these remittance operations has been intimately connected with the circumstance that the maintenance of exchange at a certain rate was dependent to some extent on the discretion of Government. Having regard to the statutory obligation which we propose should be imposed on the Bank, to maintain the Indian currency stable within the gold points of a fixed parity, we see no urgent reason for the publication of these exchange transactions.

Remittance during the Transition Period.

110. We do not recommend any general departure from present practice in the matter of purchase of sterling, pending the transfer of the business of remittance to the Bank. At the same time, in view of the observation which we have made on the subject of purchase by public tender, we recommend that, in order to obtain valuable experience, a trial be made of that system in India on the first suitable opportunity, purchases in the market being employed only for the purpose of "intermediates" on days when tenders are not received. In the case of intermediate purchases also, we recommend that a trial be made of the system of offering fixed prices, to be publicly announced. Further, until the business of remittance is transferred to the Reserve Bank, we recommend that a weekly return should henceforward be published by the Government showing its remittances in the preceding week, and the manner in which they were made.

Relations of the Bank, the Government of India and the Secretary of State.

111. It has already been indicated, in general terms, that it is one of the primary functions of the Reserve Bank to act as the banker of the Government and to hold its cash balances. The centralisation in its hands of these balances and of the banking reserves in India of all banks operating in India is an indispensable condition for the proper discharge of the Reserve Bank's primary duty of controlling credit and consequently the volume of the monetary circulation. It is no less indispensable that all the remittance transactions of the Government should be entrusted to it, as recommended in the preceding paragraphs, and that any balances of the Government of India and of the Secretary of State outside India should be placed in the charge of the Reserve Bank, through its branches or agencies. Only then will any danger of the Government's remittance policy interfering with the proper management of the currency be eliminated. We recognise that this recommendation involves the amendment of section 23 of the Government of India Act. We recommend that such an amendment should be made.

112. The fact that Government balances held with the Imperial Bank in India bore no interest, while funds held in London could be employed remuneratively in the money market, appears in the past to have led at times to unduly large accumulations of funds in London. As the proposed plan contemplates that the surplus profits of the Bank should accrue to the Government, there appears to be no longer any good reason why this practice, militating as it inevitably does against the smooth working of the management of credit and currency, should be continued. The arrangement contemplated need not impair the valuable connection of the Bank of England with Indian financial affairs, as the Reserve Bank would, without doubt, closely collaborate with it in the ordinary course.

Note Issue and Reserve Requirements.

General observations.

113. Before setting out in detail the conditions which are to govern the note issue of the Reserve Bank under the proposed plan, a few general observations must be made on the Bank's responsibilities, and the machinery by which it is enabled to discharge them.

The primary task of the Bank.

114. The goal of all monetary policy is the achievement of stability of the purchasing power of the monetary unit, and the condition under which the sole right of note issue is entrusted to the Bank must clearly be the obligation to maintain stable the purchasing power of the rupee, both internally and externally. This stability will find expression internally in the stability of the general level of commodity prices, and externally in the stability of the purchasing power of the monetary unit in relation to gold, and consequently in relation to all exchanges with countries whose currencies are linked to gold through either a gold or a gold exchange standard. To assure this stability, it is indispensable that the obligation should be put upon the Bank at all times to buy and sell gold at fixed prices which are laid down in the charter. The question as to what these prices should be will be discussed later on.

The means to accomplish it.

115. What is the machinery which enables the Reserve Bank to undertake this obligation? The sole right of note issue, and the stoppage of all further issues of money by the Government of India except through the Bank, coupled with the power to impose upon the country a judicious credit policy—these give the Reserve Bank the means to control the volume of the monetary circulation in India, and thus to stabilise the purchasing power of the monetary unit. So long as the volume of the monetary

circulation does not exceed, or fall short of, the amount of money at any time needed for the exchange of the quantity of goods and services, which have to be exchanged (regard being had to the "velocity of circulation" and the frequency with which goods and services are exchanged), the purchasing power of the rupee will remain stable. The restriction of the monetary circulation within these limits is the fundamental condition for internal stability, while internal stability is the main factor to achieve external stability. To appreciate this, we need only think of the repercussions which instability of the general level of internal prices has upon the foreign trade of a country. A rise of internal prices (that is, a fall of the internal purchasing power of the monetary unit) relative to the world level of gold prices, will inevitably impede exports and stimulate imports, and cause the balance of foreign payments to be upset, and, with it, the exchanges. An internal depreciation of the monetary unit thus very soon produces external depreciation. The reverse is the case when internal prices fall below the world level of gold prices. It clearly follows that stability of internal prices in relation to the world level of gold prices will prevent those repercussions, and will therefore prevent instability of the external value of the monetary unit, that is, of the exchanges. And if the exchanges are stable, and keep within the upper or lower gold points set by the fixation of the price at which the Reserve Bank undertakes to buy and sell gold, it will not be called upon either to buy or sell gold. Provided, therefore, the Bank follows a judicious policy of limiting the monetary circulation to the actual needs of the country by an appropriate credit policy, and so keeps the internal value of the rupee stable, the obligation to buy and sell gold will cause it no embarrassment.

116. It is evident that a limitation of the monetary circulation to the real needs of the country postulates contraction and expansion of the currency in accordance with those needs. In a mainly agricultural country like India those needs fluctuate widely, not merely according to the seasons of the year, but also according to the abundance or otherwise of crops and the prices they command. If that part at any rate of the notes which the Bank issues to meet the need of expansion is secured by assets of a character corresponding to this need of expansion, that is, if these assets mature and are liquidated when the increased monetary circulation is no longer needed, the process of expansion and contraction becomes almost automatic. The true commercial bill, that is a bill drawn in respect of a genuine commercial transaction, has these characteristics in a pre-eminent degree. It is a self-liquidating asset in the sense that the liquidation of the commercial transaction liquidates the bill. It is for this reason that the charters of most of the central note-issuing banks provide for their note issues to be secured partly by commercial bills. The charter of the Reserve Bank of

India should contain a similar provision. With a view to promote the growth of these commercial bills we recommend that the stamp duty on bills of exchange be abolished.* With the same aim, we also recommend the sale by post offices of bill forms in the English language and the vernacular in parallel.

We now turn to the other assets which are to be held by the Bank to secure its note issue.

Reserve to assure external stability.

117. While internal stability is a fundamental condition to assure the external stability of the rupee, it is nevertheless essential that the note issue should be secured to a substantial extent by assets which are capable of rectifying a temporary disequilibrium in the foreign balance of payments. Disequilibria are bound to occur, sometimes for seasonal causes, and sometimes for reasons of a bad harvest or financial stringency internally or externally. Gold and gold securities are the assets most suitable for this purpose, for they can be readily employed to discharge external liabilities, pending the adjustment of the disequilibrium through an appropriate credit policy by the Bank.

118. It is evident that the maximum amount which needs to be kept at any given time as a reserve to maintain the external value of the rupee is the amount by which India's payments abroad exceed her receipts from abroad at that time, or briefly, India's adverse balance of payments at any given time. But, as every sale of gold or gold exchange by the Reserve Bank operates in the direction of contracting the internal circulation, and as there is a point beyond which the contraction of the monetary circulation cannot be carried, it may be said that the size of the gold reserve need not exceed the maximum amount to which currency can be so withdrawn from circulation.

119. If notes were the only token money circulating in India, it would be a comparatively simple matter to determine to what extent they are to be secured by gold assets. The experience of other central note issuing banks is a valuable guide in this respect.

120. But the problem in India is a more complex one, due to the fact that the circulation of fiduciary money of unlimited legal tender in India consists of rupee coin as well as of notes, that the amount of rupee coin in issue cannot be assessed accurately, and that an unknown, but certainly substantial, proportion of

* It was stated in evidence that in America there was at one time a stamp duty on bills of exchange. It was found to restrict the development of the type of paper essential to the functioning of a money market, to render difficult the adjustment of the Federal Reserve Bank rates and to interfere with the operation of the Reserve Bank. This duty was the first to be abandoned when at the end of the recent war America undertook the reduction of taxation.

rupees in issue does not ordinarily serve as a medium of exchange, but is held as a store of wealth. Rupees which do not ordinarily serve as a medium of exchange, when employed for the purchase of gold at the Reserve Bank, do not cause a contraction of the monetary circulation in the accepted sense. Their use for this purpose does not therefore produce the automatic reaction on internal prices which is produced by a contraction of that part of the rupee circulation which is doing money's work.

121. The system of currency which we recommend makes it improbable, however, that these rupee hoards will be presented immediately for conversion into gold, for none of its provisions create an incentive to do so. It seems, nevertheless, desirable to provide for this contingency, for the Reserve Bank could obviously not face the strain and loss which would fall on it if these rupees were tendered in wholesale fashion for conversion into gold, and if it had to sell them for the value of their silver contents. To safeguard its position the following measures are recommended. There should be added to the liabilities, over and above the liabilities in respect of the note issue, an amount of Rs. 50 crores which is to be secured by assets in the same manner as if it formed part of the note issue. The Bank should, moreover, be given the right to deliver to the Government against payment in the form of notes, gold or gold securities (at the rate of Rs. 4 for each Rs. 5 of rupee coin), all the rupee coin coming into its possession in excess of certain specified amounts, which are to be regarded as the upper limits to which rupee coin may be held as a reserve asset.

122. The effect of this provision is that, if and when silver rupees are withdrawn from circulation as redundant, the obligation to finance the withdrawal falls on the Government of India, and that is the quarter in which it should fall, because it was the Government that put them into circulation. But to assist in the finance, under the five to four ratio the Government of India, as is reasonable, receive back from the reserves, *pari passu* with the withdrawal, an amount which may be regarded as roughly equivalent to the original profits on coinage the proceeds of which, accumulated in the Gold Standard Reserve, we propose to make over to the Bank.

123. The official witnesses in India have submitted estimates tending to show that the total amount of rupee coin at present in issue is from 350 to 400 crores. Taking the latter figure, and deducting from it 150 crores, as the amount which, in their opinion, could in no event be spared from the circulation, they come to the conclusion that an amount of Rs. 250 crores may be regarded as that part of the rupee circulation which does not primarily serve monetary purposes. Differences of opinion exist as to the minimum

amount of rupees required by the large masses of the Indian population for the carrying on of small transactions. We are unable to frame any reliable estimate of this amount, but we do think that, in order to establish the new system on the safest basis, we should take the safest figure of rupee contractibility, *viz.*, that put forward by the official witnesses, as our guide. The figure of 250 crores includes Rs. 85* crores of silver coin and bullion now held in the Paper Currency Reserve, of which, on the basis of the figures given for purposes of illustration in paragraph 144 below, 67 crores should be handed over to the Reserve Bank on taking over the note issue, while the balance of 18 crores should be retained by the Government for gradual disposal. If, as does not seem unlikely, the 67 crores gradually go into circulation, the total amount of rupees that might then be spared from circulation may be assumed to amount to about 232 crores. It is this amount which, while outstanding, would be secured by the 50 crores of addition to the Reserve. If and when these rupees come back from circulation and are delivered to the Government under the before-mentioned proposal, these 50 crores will be diminished at the rate of 1 rupee for every 5 rupees of redundant rupees delivered. In the event of further rupees being issued by Government on the Bank's demand, this process would, of course, be reversed.

124. Having in this manner provided for the possibility of hoarded rupees being converted into gold, it remains to deal with the gold and gold security reserve to be provided for that part of the monetary circulation, which truly serves as a medium of exchange. If it be assumed that 150 crores of rupee coin can in no circumstances be spared from the circulation—and this is the minimum estimate—we have finally to determine what proportion of the notes in issue can be spared from circulation, and what gold and gold security reserves should be held for the purpose.

The system of note issue.

125. Before we can proceed with this question further, it is necessary to consider the system of note issue which is likely to prove most suitable to the particular conditions of India, and which it is therefore desirable to adopt.

If we go by the precedents of the currency legislation of other countries, we have two well-defined systems to choose from.

126. There is first what may briefly be termed the fixed fiduciary issue system, which has been adopted by England under its Bank Charter Act of 1844. By this Act the Bank of England is

* See first footnote on page 6.

authorised to issue its own notes on the security of Government Debt to an amount fixed by statute. Any additional notes over and above this fixed fiduciary limit have to be secured by a gold backing of 100 per cent. The system rests on the thoroughly sound doctrine that there is a minimum of currency which must always remain in circulation unless the mechanism of exchange is to break down completely, and that, so long as the fiduciary issue is well within that minimum, there is no danger of the purchasing power of the currency being adversely affected.

127. The Act of 1844 requires the separation of the business of note issuing and banking into two separate departments—the Issue Department and the Banking Department. The Issue Department deals exclusively with the issue and redemption of notes. It holds the gold reserves, and creates on their security and on the security of the fixed amount of Government Debt all the notes that it is entitled to create under the Act. The notes so created and issued to the public constitute the active circulation, while the balance of notes created but not issued to the public constitutes the Reserve, which Reserve is held by the Banking Department. That Department is concerned with the discount, credit, and banking business generally. The size of that Reserve constitutes the limit to which the currency can be expanded. If more currency is needed (as, for instance, in a severe crisis), nothing remains but to suspend the Bank Act. That, as is well known, has happened three times in the history of the Act up to the outbreak of the great war.

128. It will be appreciated that, under this system, expansion or contraction of the note issue beyond the fixed fiduciary limit takes place at a rate exactly corresponding to the increase or decrease of the gold reserves. The system is a cautious one, but safety is secured at the expense of elasticity. In spite of its rigidity, however, the system has worked well in England, not because expansion and contraction are not as necessary there as they are in other countries, but because the widespread development of the joint stock banking organisation of the country has led to the cheque, and not the bank note, being the chief medium of exchange. Expansion and contraction of the currency in England thus takes place through the cheque currency, and so imparts to the system the necessary elasticity.

129. The other system which might be chosen is that in operation in many of the countries on the continent of Europe, in the United States under the Federal Reserve system, and in South Africa. It may conveniently be termed the proportional reserve system. The system does not require the note issuing and banking functions to be separated into two departments. Under it, the notes in active circulation are secured by a minimum percentage of gold or gold securities, which is laid down by statute, and which

is 40 per cent., in the case of the Federal Reserve System and in South Africa, and is less in other countries. These minima, however, are not rigidly fixed, but may be transgressed with the consent of the Government for short periods on the condition that the issuing bank pays a tax reckoned on the amount of the deficiency. This tax is made to rise steeply as the deficiency increases. It will be appreciated that the fact that the Government's permission has to be obtained, and that this permission is only given for comparatively short periods, and further, that the bank has to pay a steeply rising tax, forces the bank to take prompt measures to redress the situation by an appropriate credit policy. It will also be appreciated that, under this system, an actual suspension of the Bank Act need not take place.

130. Its chief characteristic is that expansion and contraction do not, as in the case of the fixed fiduciary issue, take place at the same rate as the gold reserves increase or decrease, but that it permits expansion, and forces contraction to take place (assuming as an example the Federal Reserve system), in the proportion of 100: 40. An addition of 40 units to the gold reserve permits the bank to issue notes to the amount of 100 units. Conversely, a loss of reserves of 40 units forces a contraction of notes to the extent of 100 units. The system thus permits of a far wider range of expansion and contraction than the fixed fiduciary issue system. It should be mentioned, however, that the Central Banks working under this system ordinarily maintain a reserve ratio far above the legal minimum. Their reserve, in pre-war days under normal conditions, used to be in the neighbourhood of 50 to 60 per cent. The system, it will be seen, possesses the quality of elasticity to a far greater extent than the fixed fiduciary system. The objection is sometimes raised that, because of this greater elasticity, it lends itself to inflation, and is therefore less to be recommended than the fixed fiduciary issue system. It may, on the other hand, be said that, as the fixed fiduciary issue system can only work satisfactorily where the chief medium of payment is not the note bu the cheque, the scope for inflation through an undue expansion of credit is just as great as it is in the case of the proportional reserve system, with legal tender money as the chief medium of exchange. Both systems obviously require prudence in the management of currency and credit.

Proportional reserve system recommended for India.

131. Joint stock banking and the use of the cheque as currency are already developing in India, but they can hardly be expected to develop sufficiently quickly to mitigate the rigidty of the fixed fiduciary issue system. In the past complaints have often been heard that the Indian paper currency has been made unduly rigid by the attempt to imitate the provisions of the English Bank Charter Act. The need for seasonal expansion and contraction in

India is particularly pronounced owing to the mainly agricultural character of its internal economy. We therefore recommend the adoption of a proportional reserve system of note issue; and the outlines of the charter presented later in this Report have been framed on that principle.

Gold and gold security reserve.

132. In the light of the experience of other note-issuing banks which are working this system, it seems safe to provide for the gold and gold securities in the reserve to be not less than 40 per cent. of the liabilities, *i.e.*, of the notes in issue *plus* the 50 crores on account of outstanding rupees. The Bank would, of course, in normal times, work to a percentage much higher than the 40 per cent. minimum.

Other reserves.

133. The remainder of these liabilities might be secured by Government of India rupee securities and rupee coin, though certain qualifying conditions should be made in regard to their use as reserve assets.

134. Dealing first with the use of rupee coin for the purpose, the following considerations are relevant. The scheme under consideration contemplates no statutory obligation upon the Reserve Bank to convert its own notes into rupee coin. There is therefore no logical necessity for the Bank to hold rupee coin in its Issue Department (though it will doubtless hold it in appropriate quantities in its Banking Department) when once the Government of India notes have been replaced by Reserve Bank notes. The desirability of eliminating rupee coin from the Issue Department is emphasised when its worth as a reserve asset is examined. From the point of view of the management of the currency by the Bank, the rupee coin is indistinguishable from the notes it issues, in spite of the fact that the rupee, appropriately described as a "note printed on silver," is made of a more costly material than the paper note. Both are tokens depending for their purchasing power upon the limitation of their issue, and both require to be secured by an adequate amount of gold and gold securities to assure their external value. The fact that some 85* crores of rupees have found their way into the Paper Currency Reserve is proof that, for the time being at any rate, they are redundant. Hence their unfitness as an asset to secure the stability of the purchasing power of the currency.

135. On the other hand we propose, for the reasons indicated in paragraph 69 above, to make it incumbent on the Bank to supply rupees freely to the public in such quantities as may be required for circulation, and we propose to lay on the Government the duty of supplying rupees to the Bank in order to enable it to

* See first footnote on page 6.

carry out this obligation. It is conceivable that a large rise in the price of silver might prevent the Government from discharging this duty, in which case the Bank would be freed from its obligation. But so long as the obligation prevails it is reasonable to permit the Bank to hold some of the rupees required to fulfil it in the Reserves of the Issue Department. The present stock is undoubtedly excessive, and we propose that a part of it should be retained by Government. The balance of (say) 67 crores will be made over to the Issue Department at the outset, and it is not unlikely that a considerable portion will be absorbed as a necessary addition to the currency in the first few years. If rupees are wanted for this purpose they will automatically flow out of the Issue Department, and will then be replaced by assets of a more desirable kind, such as commercial bills, or gold. If, on the other hand, they are not wanted, and do not flow out of the Issue Department, they are clearly undesirable as a reserve asset, and should therefore be got rid of deliberately and be replaced by assets of a more eligible character.

These considerations have led to a provision being included in these proposals to limit the quantity of rupee coin which the Bank is permitted to hold in its Issue Department to gradually diminishing amounts spread over 10 years.

136. Dealing with the question of the propriety of including Government of India securities among the reserves, it is easy to appreciate that they form a far less desirable asset than commercial bills, for they lack that most useful quality of the latter to expand and contract the currency automatically in accordance with the needs of the country. In the case of Government securities, expansion and contraction depends entirely upon the will and judgment of the currency authority, and is therefore more liable to errors of judgment. A large holding of Government securities, moreover, might give rise to difficulties in connection with their realisation if the need for it arose. Their inclusion among the reserve assets of the Issue Department can therefore only be justified if the amount held is limited to only so much of the circulation as is unlikely, in any circumstances, to be withdrawn, *plus* such further amount as can in all probability be realised without causing an undue disturbance of the Government's credit.

Even the conditional utility which attaches to ordinary securities is absent in the case of the "created" securities that now find a place in the Reserve. In respect of these, we recommend that the Government should be required to replace them by marketable securities gradually within a period of 10 years.

Separation of the Banking and Issue Departments.

137. We have stated above that the proportional reserve system does not necessitate the separation of the banking and note issuing

functions of a Reserve Bank. Wherever the system is in operation no such separation is in fact made. If, nevertheless, in the plan submitted in our Report such a separation is proposed, it is because we have been impressed by the view put forward by many witnesses that the accounts of the Reserve Bank should be presented in the simplest possible form, and that it is essential from this point of view to set out in a separate statement the assets and liabilities in respect of the note issue. We think that such a separation would inspire greater confidence in the new note. Although this is a novel way of dealing with the matter, there would seem to be no strong reason why it should not be adopted.

Government Guarantee of the Bank Note.

138. We recommend that the notes of the Bank shall be guaranteed by the Government of India. The purpose of this guarantee is to promote confidence in the notes of the Bank. A double change is proposed in the status of the note. It is to be a bank note instead of a Government note, and it is to be convertible into gold bars and not as of right into silver rupees as in the past. In order to obviate any discredit that might attach to the new note in consequence of these changes, it is in our opinion essential that the note should be guaranteed by the Government at least for the first period of the Bank's charter. We propose below a provision which will adequately secure the Government in respect of that guarantee.

Outlines of the Proposed Provisions of the Charter.

139. It will be convenient now to formulate, amplify and summarise the plan for the Reserve Bank which we recommend, in the form of outlined provisions for a charter.

Relations with the Government of India and the Secretary of State.

140. The provisions of the charter dealing with the relations of the Bank, the Government of India and the Secretary of State, should be framed to cover our general recommendations, as follows:—

The Bank undertakes to accept monies for account of the Government of India and the Secretary of State and to make payments up to the amount standing to the credit of their accounts, and to carry out all their exchange, remittance, investment and other banking operations, including the management of the Government of India Debt, on conditions to be mutually agreed upon.

The Government of India and the Secretary of State undertake to entrust the Bank with all their money, remittance, exchange and banking transactions in India, London and elsewhere, subject, in the case of London, to existing or future arrangements with the Bank of England, and in particular to deposit, free of interest, all their cash balances and to concentrate all their money transactions at the Bank, its branches or agencies. The Government of India and the Secretary of State undertake, further, to entrust the Bank with any transactions they may desire to undertake in gold and securities, as also their ordinary transactions in silver, with the management of the Government of India Debt both in India and in London, and with the issue of any new loans, subject, however, to existing or future arrangements with the Bank of England in regard to the management of the Government of India Debt in London and the issue of new loans there.

Note issue.

141. The Bank shall have the sole right to issue bank notes in India for a period of (say) twenty-five years, provided that the Government of India may continue to issue notes as heretofore during such time as the Bank requires to put itself in a position to issue its own notes in substitution for the Government of India notes now in circulation. As soon as the Bank has notified the Government that it is in a position to issue notes, the Government shall cease to issue or re-issue its own notes, or any other type of paper money. Not later than five years from the date of the charter becoming operative the Government of India notes still outstanding shall cease to be legal tender except at Government treasuries.

Denomination of notes.

142. The denominations of the notes issued by the Bank shall be 1, 5, 10, 50, 100, 500, 1,000 and 10,000 rupees, or such other denominations as may be approved of by the Governor-General in Council.

Issue Department.

143. The issue of bank notes shall be conducted by the Bank in a department to be called "The Issue Department," which shall be separated and kept wholly distinct from the department in which its general banking business is carried on and which is to be called "The Banking Department." The assets of the Issue Department shall not be subject to any liability other than the liabilities of the Issue Department as defined in the charter (*see* paragraph 146). It shall be lawful for the Central Board of Governors, if they think fit, to appoint a Committee, or Committees, of Governors for the conduct and management of the Issue Department, and from time to time to remove the members, and define, alter and regulate the constitution and powers of such Committee as they shall think fit. Provided nevertheless that the Issue Department shall always be kept separate and distinct from the Banking Department.

Transfer of reserves to the Issue Department.

144. There shall be transferred and appropriated by the Government of India to the Issue Department of the Bank the following assets, to be set forth in detail in a schedule to be attached, *viz.*:—

	Crores.
Rupee coin of a face value of	67
Rupee securities of a market value of . .	50
Gold securities of a market value of . .	88
Gold coin and bullion at par value . .	30
	235*

Thereupon there shall be delivered by the Issue Department to the Banking Department such an amount of bank notes as, together with the Government of India notes then in circulation, shall be equal to the aggregate amount of the rupee coin, rupee securities, gold securities and gold coin or bullion so appropriated to the Issue Department, less a sum equal to the amount of the rupee redemption liability referred to in the section (paragraph 146 below) dealing with the " Definition of liabilities of the Issue Department."

From and after such transfer and appropriation to the Issue Department, it shall not be lawful for the Issue Department of the Bank to issue its notes to the Banking Department except in exchange for other notes of the Bank, or Government of India notes, or for gold coin and bullion, or gold securities, or rupee coin, or Government of India securities, or such bankable bills of exchange as are permitted under the charter to form the security for the issue of the Bank's notes. Provided always that it shall be lawful for the Banking Department to pay out all Reserve Bank notes which it shall at any time receive from the Issue Department, or otherwise, in the same manner as such payment would be lawful if made by any other person.

Reserve requirements.

145. The character of the Reserves, which it shall be lawful for the Issue Department to hold as security for its liabilities, should be closely defined. Of its *holding of gold coin or bullion*, at least one-half shall be held in the Bank's custody in India, while the remaining half may be held outside India in the custody of its branches or agencies or deposited in other banks earmarked for the Bank's account. Gold in any Mint or in transit belonging to the Bank shall be counted as part of its reserves.

* These figures are as shown in Schedule III. based on the note circulation figures of 30th April, 1926, and are illustrative only.

The *gold securities* which it shall be lawful for the Issue Department to hold as part of its Reserves shall be securities the capital and interest of which shall be payable in a currency which is exchangeable into gold on demand and exportable in that form. They may be the following:—

(*a*) Balances standing to the credit of the Issue Department of the Bank at the Central Note Issuing Bank of a foreign country;

(*b*) Bills of Exchange of a maturity not exceeding 90 days bearing at least two good signatures drawn on and payable at a foreign money centre;

(*c*) Securities of Governments other than the Government of India.

Provided that for a period of 2 years from this charter becoming operative the Issue Department may hold Government of India sterling securities to an amount not exceeding Rs. 7 crores, and provided further that, after the lapse of 2 years at least one-half of the securities of Governments other than the Government of India shall be of a maturity not exceeding 5 years.

The Reserves to secure the liabilities of the Issue Department must consist of gold or gold securities to an amount of not less than 40 per cent. of these liabilities, provided that the holding of gold coin and bullion shall not be less than 20 per cent. of the liabilities after the end of the 5th year and 25 per cent. of the liabilities after the end of the 10th year from the date of the charter becoming effective. In no case, however, shall it be less than Rs. 30 crores. In order to enable the Issue Department of the Bank to show in its opening accounts a reserve ratio of not less than 50 per cent., that is to show a good margin above the minimum requirement, the Government of India should be required to replace any necessary amount (Rs. 7 crores, on the basis of the figures of note circulation on the 30th April last) of created rupee securities by gold securities. If the Government should find it inconvenient immediately to provide other suitable gold securities, they may be allowed to replace such rupee securities by an equivalent amount of Government of India sterling securities (created *ad hoc*), these to be replaced within 3 years by gold securities of the kinds specified above.

The balance shall be secured by the holding in the Issue Department of rupee coin, Government of India rupee securities and such domestic drafts, bills of exchange and bankers' acceptances as are eligible for purchase by the Bank under this charter, provided that the rupee coin held shall not exceed the amounts specified in the following table, or 10 per cent. of the liabilities of the Issue Department, whichever is the greater:—

Rs. 70 crores until the end of the third year, Rs. 50 crores from the end of the third to the end of the sixth year,

Rs. 35 crores from the end of the sixth to the end of the tenth year,

Rs. 25 crores thereafter;

and provided further that the Government of India rupee securities held shall not exceed 25 per cent. of the liabilities with a maximum (overriding) of Rs. 50 crores.

At the outset, any excess in the combined assets of the Paper Currency and Gold Standard Reserves over the liabilities (as defined in the next succeeding clause) shall be retained by the Government in the form of silver bullion and coin. Schedule III to our Report shows, on the basis of the figures of 30th April, 1926, the assets and liabilities of the Issue Department.

Definition of liabilities of the Issue Department.

146. The liabilities of the Issue Department referred to in the preceding paragraph (Reserve Requirements) shall be an amount equal to the amount of Government of India and Bank notes in issue *plus* an initial amount of 50 crores in respect of "rupee redemption," which latter amount is to be reduced by one rupee for every five rupees delivered to the Government of India by virtue of the provisions in the next succeeding paragraph. The reverse procedure shall be followed when rupees are issued by the Government to the Bank, *i.e.*, the rupee redemption liability will be increased by one rupee for every 5 rupees so issued.

Right to deliver redundant rupees to Government.

147. The Bank shall have the right to deliver to the Government of India against payment of four rupees in notes, gold or gold securities for every five rupees coin so delivered all the rupee coin of which it may become possessed in excess of the amount which, under the clause headed "Reserve Requirements," it is permitted to hold as part security for the liabilities of the Issue Department. Conversely the Bank shall be entitled to obtain rupees current under the Coinage Acts from the Government of India on payment of 4 rupees in notes, gold or gold securities for every 5 rupees so obtained.

148. The Government of India shall undertake not to re-issue any rupee coin delivered under this or the preceding clauses nor to coin and put into circulation any fresh rupees, except to the Bank and on the Bank's demand. The Bank, on the other hand, shall undertake not to dispose of rupee coin otherwise than for the purposes of circulation or by delivery to Government as hereinbefore prescribed.

Notes to be legal tender and guaranteed by Government.

149. The notes of the Bank shall be legal tender for the payment of any amount, and shall be guaranteed by the Government of India. If and when the Bank fails to comply with the provisions of clauses 150-151 to buy and sell gold on the prescribed conditions, and the Government's guarantee thus becomes operative, or if and when it fails to comply with any other provision of the charter, which in the opinion of the Governor-General in Council is essential, the assets held in the Issue Department shall become the property of the Government so far as they are required to meet the liability of the notes or of rupee redemption. Such failure shall involve the forfeiture of the privilege of note issue, unless it were caused by an impediment due to *force majeure* and recognised as such by the Governor-General in Council.

The Bank to sell gold.

150. The Bank shall sell to any person who makes a demand in that behalf at its offices at Bombay, Calcutta or Madras, during the office hours of the Bank, and pays the purchase price in any legal tender money, gold bullion for delivery at its Bombay office at the price* of Rs. 21 as. 3 ps. 10 per tola (180 grs.) of fine gold, but only in the form of bars containing approximately 400 ozs. (1,065 tolas) of fine gold. Provided that whenever the market rate for the selling price of telegraphic transfer on London is less than the upper gold point of the exchange as defined below, the Bank shall sell gold as aforesaid for delivery at its office at Bombay or in London at the option of the purchaser at prices hereinafter called the notified prices.

The upper gold point referred to above is equivalent to 1*s.* 6*d.* gold *plus* a proportionate amount to cover the cost of shipping gold bullion from London to Bombay, including packing, freight, insurance, and loss of interest, and shall be determined and published in the same manner as the notified prices. The notified price for delivery in London shall be the said price of Rs. 21 as. 3 ps. 10 per tola, with the addition of an amount corresponding to the expenses of the shipment of gold bullion from Bombay to the Bank of England, London, including packing, freight, insurance, and loss of interest. The notified price for delivery in Bombay shall be the said price *plus* an amount corresponding to twice the said expenses. The notified prices shall be calculated by the Bank from time to time as necessary. They shall be submitted to the Government of India, which shall satisfy itself that they have been calculated in the manner provided above, and certify the same. They shall be published with the certificate by notification

* The figures in this paragraph are based upon our recommendation in section IV of the Report regarding the parity of the rupee.

in the Gazette of India, and the publication of the notification and certificate shall be conclusive as between the Bank and all parties as to the prices at which the Bank shall sell gold.*

The Bank to buy gold.

151. The Bank shall be obliged to buy from any person who makes a demand in that behalf at its offices in Bombay, Calcutta, and Madras, during the office hours of the Bank, in exchange for any legal tender money, gold bullion for delivery at its Bombay office at the price of Rs. 21 as. 3 ps. 10 per tola of fine gold, but only in the form of bars containing approximately 400 ozs. (1,065 tolas) of fine gold; provided always that the Bank shall in all cases be entitled to require such gold bullion to be melted and assayed by persons approved by the Bank at the expense of the parties tendering such gold bullion.

The Bank to maintain the free interchangeability of the different forms of legal tender currency.

152. It shall be the duty of the Bank to maintain the free interchangeability of the different forms of legal tender currency. It shall issue notes on demand in exchange for rupees and it shall, in exchange for notes of Rs. 5 or upwards, supply notes of lower value or rupees or other token coins in such quantities as may be required for circulation. It will be the duty of the Government to supply such silver rupees or other token coins to the Bank on demand. Should the Government at any time fail to discharge this duty the Bank will be released from its obligation to supply such coins to the public.

Suspension of Reserve requirements and tax on note issue.

153. The Bank shall be authorised and empowered, subject to the consent of the Governor-General in Council, to suspend for a period not exceeding 30 days, and from time to time to renew such suspension for periods not exceeding 15 days, the requirements as to gold and gold securities reserve specified in the charter; provided that, upon the amounts by which the reserve for the notes falls below the requirements of the charter in respect of such notes, a tax shall be paid to the Government equal to the Bank's discount rate in force at the particular period *plus* one per cent. per annum when the gold and gold securities reserve against the notes is less than 40 per cent. but more than $32\frac{1}{2}$ per cent. and an additional $1\frac{1}{2}$ per cent. per annum in respect of each $2\frac{1}{2}$ per cent. decrease or part thereof by which the reserve falls below $32\frac{1}{2}$. Provided that the tax shall in no event be less than 6 per cent.

* As to the calculations concerned, *see* Schedule I.

Bank exempt from further note tax.

154. The Bank shall be exempted from the payment of any tax or duty upon its note issue, other than the graduated tax provided for in the last preceding paragraph.

Condition of note currency.

155. The form and material of the notes issued by the Bank shall be approved by the Governor-General in Council.

The Bank shall not re-issue notes which are torn or partially defaced or are soiled by excessive handling, and provision shall be made by the Bank for the disinfection and sterilization of notes before re-issue.

In order to express on the face of the new note the cardinal features, *viz.*, the guarantee of Government and the fact that it is essentially a Bank note, we suggest that its form should be as follows:—

RESERVE BANK OF INDIA.

GUARANTEED BY

THE GOVERNMENT OF INDIA.

ONE HUNDRED RUPEES.

Reserve Bank of India notes are legal tender for the payment of any amount and are convertible into gold in accordance with the provisions of.................... Act of.................

Issued by the Reserve Bank of India under the authority of the above Act.

....

Chief Cashier.

Audit.

156. The provisions of the Imperial Bank of India Act, 1920, Schedule II, regulations 58 to 60 inclusive, regarding the election of auditors, the right of the Governor-General in Council to appoint an auditor, and their rights and duties, seem appropriate and should be embodied in the new charter, with one modification, namely, that instead of three auditors, the new charter shall provide for not less than two auditors or firms of auditors.

Returns.

157. (1) The Bank shall make up and transmit to the Governor-General in Council weekly an account of the Issue Department and of the Banking Department in the form set out in Schedule IV. The Government shall cause copies of these accounts to be published in the next succeeding issue of the Gazette of India.

(2) The Bank shall also, within two months from the close of each half of the financial year, transmit to the Governor-General in Council a copy of its half-yearly accounts, signed by the Managing Governor, Deputy Managing Governor, and the Chief Accountant of the Bank, and certified by the auditors, and the Government shall cause such copies to be published in the Gazette of India.

(3) The Bank shall also, within 60 days after the 31st December in each year, transmit to the Governor-General in Council a list giving the names, addresses and occupations and the number of shares held by each shareholder of the Bank.

Bank-rate.

158. The Bank shall make public from time to time the minimum rate at which it is prepared to buy or rediscount bills of exchange, or other commercial paper eligible for purchase under the charter.

Secrecy as to the business of the Bank.

159. The Governors, officers and employees of the Bank shall be obliged to maintain secrecy in regard to the affairs of the Bank and its customers, and any person contravening this provision shall be liable to a heavy pecuniary fine or imprisonment, or both.

Falsification of books, statements, etc.

160. Any Managing Governor, Deputy Managing Governor, Governor, officer, or employee of the Bank—

(*a*) who falsifies any account, statement, return or other document respecting the affairs of the Bank, with intent to defraud or in a manner calculated to deceive shall be guilty of an offence and liable on conviction to imprisonment or to a fine or to both;

(*b*) who negligently and in breach of his duty makes, prepares, signs, approves or concurs in any account, statement, return or other document respecting the affairs of the Bank containing any false or deceptive statement, shall be guilty of an offence, and liable on conviction to imprisonment, or to a fine.

Cash Reserves to be maintained by banks and bankers against deposits.

161. It seems highly desirable that the Bank Act should also include provisions compelling every bank or banker transacting business in India, from a date to be notified by the Governor-General, to establish and maintain minimum reserve balances with the Reserve Bank equal to 10 per cent. of its or his demand liabilities to the public in India, and 3 per cent. of its or his time liabilities to the public in India. It should be made obligatory upon every bank or banker transacting business in India to make a return at the end of each month, signed by the Chief Officer and Chief Accountant, or, in the case of a private firm, a Partner and the Chief Accountant of the firm, and to send such return to the prescribed officer of the Government and to the Bank, showing:—

(*a*) The amount of the demand and time liabilities respectively to the public in India;

(*b*) The amount of Government of India and Bank notes respectively held in India;

(*c*) The amount of rupee coin and subsidiary coin respectively held in India;

(*d*) The total amount of advances and discounts respectively in India; and

(*e*) The reserve balances held at the Reserve Bank.

Failure to comply with this provision should be subject to a penalty recoverable by action in a competent court. A summary of such monthly return for each bank or banker should be published in the Gazette of India.

When it appears from any monthly return that any bank or banker has failed to maintain the required reserve balances it shall be competent for the Government of India to call for such further return, or make such inspection of the books and accounts of the bank in default as may be necessary to ascertain the amount of the deficiency and period during which it continued. The bank so in default shall incur a penalty at a rate per annum which shall be 3 per cent. above the Reserve Bank's official discount rate on the amount of the deficiency for each day that it continued. The penalty shall be raised to 5 per cent. above the Reserve Bank's official discount rate after the first seven days of the deficiency. No bank or banker may at any time make new loans or pay dividends unless and until the reserve balance required under this section is restored.

Interpretation of term "Bank or Banker."

162. We suggest that the term "bank or banker" should be interpreted as meaning every person, firm, or company, using in its description or title "bank" or "banker" or "banking,"

and every company accepting deposits of money subject to withdrawal by cheque, draft, or order. We recognise, however, that in view of the special conditions of indigenous banking in India, this matter will require more detailed consideration than we have been able to give to it, and we recommend that it be further examined.

Functions and capacities of the Bank.

163. The functions and capacities of the Reserve Bank shall be as defined in Schedule II.

Regulations.

164. A provision should also be inserted in the charter giving the Governor-General power to make, from time to time, regulations, not inconsistent with the charter, prescribing all matters which are required or permitted to be prescribed, or which are necessary or convenient to be prescribed, for giving effect to the provisions of the charter.

Time Table.

165. The above proposals cannot, of course, all be brought into operation at once. The existing agreement with the Imperial Bank of India, for instance, is not due to expire until the 27th January, 1931, and the contract with the Bank of England for the supply of Government notes is not due to expire until the 30th June, 1929. The earlier termination of either agreement could no doubt be negotiated. On the assumption that the necessary arrangements are made, we recommend the following time table for the chief changes:—

> The transfer of assets referred to in paragraph 144 should be made as soon as the Reserve Bank notifies that it is in a position to issue its own notes, but not later than 1st January, 1929.
>
> The obligation to buy and sell gold should come into operation on a date to be approved by the Governor-General in Council on the proposal of the Bank, but not later than the 1st January, 1931.

Transitory Provisions.

166. During the transition period the currency authority* must be under an obligation to buy gold and to sell gold or gold exchange at its option at the gold points of the accepted gold parity of the rupee. It should take whatever steps are required to convert in the safest and most gradual

* By currency authority is meant the Government of India or the Reserve Bank of India, whichever is in control of the note issue.

manner a portion of the sterling balances into gold bullion, and should pursue a policy calculated to strengthen the position of the Bank in relation to gold when it assumes charge of the currency and the Reserve.

We desire expressly to emphasise that this recommendation as to the transition period is of the essence of our proposals. The Government of India should at once publicly announce its acceptance of the obligation as defined, and should fulfil it without variation during the period of transition. We are of opinion that this obligation should be embodied in statutory form. In Schedule V we suggest an outline form for such statute.

Interdependence of Recommendations.

167. In conclusion, we desire to emphasise that our recommendations in the preceding sections of this Report should be regarded as a comprehensive whole and that modifications of any of their integral parts involve the danger of destroying their balance and so preventing the efficient and smooth working of the whole.

IV.—STABILISATION OF THE RUPEE.

Time for Stabilisation.

168. The system of currency which we have recommended implies the adoption of some fixed gold parity for the rupee, and the stabilisation of the rupee at that parity. It is therefore essential to our inquiry to consider whether the time is ripe for such a stabilisation of the rupee, and, if so, at what rate that stabilisation should be effected.

169. The great preponderance of opinion in the evidence which we have received is that it is desirable that the gold parity of the rupee should be fixed and that the rupee should be stabilised at that parity forthwith. It is held that the rupee should not be left to discretionary variations, with a view to the mitigation of internal price movements or for any other purpose; and it is argued that, in view of the circumstances of the times, including the return to a gold basis of the United Kingdom, the Dominions, and other countries, the time is now fully ripe for such stabilisation. Each addition to the list of countries which have stabilised their currency in relation to gold improves the prospects for the stability of gold prices.

170. In this opinion we concur. So long as no such parity is fixed, there must be uncertainty as to the future of exchange, and a consequent lack of confidence. Commercial initiative must be discouraged, and the machinery of commerce generally

must be clogged and hampered. There are therefore the strongest practical reasons for deciding upon the parity and stabilising thereat forthwith, if that can be done with safety.

171. After considering all foreseeable circumstances, we have come to the conclusion that it is safer to stabilise now than to wait. We do not overlook the fact that a certain element of instability remains in the economic conditions of the world as long as some important countries have not attained budgetary equilibrium or a stable currency. To fear, however, that even the worst disturbances that could proceed from these sources could seriously imperil the stability of Indian exchange would appear to us to imply an exaggerated caution. A stable exchange is an inestimable boon, and it should not be sacrificed or postponed for the sake of a security that is so absolute as to be unobtainable in the practical world.

172. An apprehension was expressed to us lest some considerable change in the credit policy of the United States of America, at present the chief holder of the world's monetary stock of gold, might produce a rise in world gold prices, in which India, if definitely linked to a gold standard, would be inevitably involved. As already stated on the authority of the evidence from the United States, we have satisfied ourselves that there is no such redundance of gold in the United States as would be likely to promote such a policy. Moreover, the number of countries which have returned or are returning to the gold standard is some guarantee that, with proper co-operation and management on the part of the various central banks of the world, a more even distribution of the available gold will be attained in time, so that world price levels will be less dependent upon the policy and actions of a single currency authority than they are supposed to be at present.

173. In short, there is not in our opinion any event in the foreseeable future which would be likely to make conditions more favourable for the purpose of stabilisation than they are at present, and the outcome of which ought therefore to be awaited: and we are, in consequence, of opinion that stabilisation should be effected forthwith.

The Ratio of Stabilisation.

174. The legislation of 1920 has fixed the statutory value of the rupee at 2*s*.; but that rate is absolutely ineffective, and the Government have declared that they do not seek to regain it. The present market rate is about 1*s*. 6*d*. It has been at that level in relation to gold since June, 1925, and in relation to sterling since October, 1924.

175. For the reasons set forth below we recommend that the rupee be stabilised in relation to gold at a rate corresponding to an exchange rate of 1*s*. 6*d*. for the rupee.*

Adjustment of Indian to world prices.

176. The chief reason for this recommendation is our conviction, which has been formed and cumulatively reinforced during the progress of our inquiry, that, at the present exchange rate of about 1*s*. 6*d*., prices in India have already attained a substantial measure of adjustment with those in the world at large, and, as a corollary, that any change in the rate would mean a difficult period of readjustment, involving widespread economic disturbance, which it is most desirable in the interests of the people to avoid, and which would in the end be followed by no countervailing advantage.

177. We shall proceed to discuss a number of relevant issues, which have been raised in this connection, and we shall examine the question from various angles; but we wish to make it clear at the outset that the central, and as it seems to us the decisive, factor is the extent to which the prevailing rate of exchange is reflected in internal prices. We are unanimous in holding the view—and, indeed, it is a proposition which it would be difficult to controvert—that, *if* it can be shown that prices have to a preponderant degree adjusted themselves to the existing *de facto* rate, then that rate must be adhered to. The further proposition, that such substantial adjustment has been secured, is a question of fact, as to which we shall now adduce the evidence on which our conviction is based.

178. It would be difficult, if not impossible, to pursue any argument on the subject of the movement of price levels, without making use of index figures in some form. We recognise that index figures are not an infallible guide, and that there are many directions in which they might lead one astray. Especial caution is necessary in using them for the purpose of comparing the range of price levels in two or more countries over a particular period, because the figures are necessarily compiled in different ways in different countries. Moreover, it is usual, for purposes of comparison, to refer them to the same basic year, and the year selected may not be equally suitable in all the cases concerned. For example, there may have been some local peculiarity in the circumstances of the basic year, or the character of production may have changed during the period in one or more of the countries.

* Throughout this part, when such expressions as "the 1*s*. 6*d*. rate," "a 1*s*. 6*d*. rupee," are used, they must be read with reference to our recommendation that the rupee should be definitely linked to gold. The expressions in question are used merely as a convenient and familiar way of referring to the gold value of the rupee.

It may be said that the index figures are more reliable in indicating the general trend of prices in each particular country than in comparing the relative levels of prices in two or more countries.

It might have been expected that the statistical employment of the doctrine of purchasing power parity would have facilitated the task of determining the proper exchange ratio to be fixed. But quite apart from the imperfections of the Indian figures of prices, the employment of index numbers for such a purpose implies the important assumption that changes in the prices of goods entering international trade have been followed by similar changes in the prices of all other goods. A caveat has to be entered against the application of the theory of purchasing power parity to general price level as determined by figures like index numbers of wholesale prices or index numbers of retail prices and cost of living. The theory can in fact supply a very approximate guidance only, and its practical utility is of a strictly limited character. Moreover, in comparing the pre-war and post-war price levels for the purposes of the theory, we have to allow for changes in tariffs and freights both at home and abroad and changes in the character of production, and these have been very important.

179. In India there are special difficulties in the way of compiling a representative index figure owing on the one hand to the great size of the country and the cost of inland transport, and on the other to defects in the statistics on which the compilation is based, defects which have been pointed out in the report of the recent Indian Economic Enquiry Committee.

180. We desire to take this opportunity of recommending that a serious and sustained attempt should be made to remedy these defects, and to lay the basis of sound economic deductions by the collection of accurate statistics, not only of prices, but also of wages, a subject which in India presents even greater difficulties.

181. Bearing the above reservations in mind we proceed to examine the data available. We draw no conclusions from the general index numbers for all India, because these are more deeply affected by the defects indicated above than are the local indices of wholesale prices compiled at Calcutta and Bombay. Of the latter the Government of India prefer the Calcutta figures. They are more comprehensive, covering 71 items against Bombay 42. We shall deal with them first, but in the graphs referred to later we have combined the two sets of figures into one.

182. From December, 1922, to June, 1924, the gold exchange value of the rupee (as measured by the cross-rate, Calcutta-London-New York) remained fairly stable round 1*s.* 3*d.* gold (the limits being about 1*s.* $2\frac{3}{4}$*d.* and 1*s.* $3\frac{1}{2}$*d.*). During the same

period the rupee price level, as measured by the Calcutta* wholesale index figure, remained fairly steady round 176 (the limits being 170 and 181). From July, 1924, to January, 1925, the rupee rose sharply to the neighbourhood of 1*s.* 6*d.* gold, and since the end of May, 1925, it has been held within the 1*s.* 6*d.* gold points. From July, 1924, to June, 1925, the rupee price level fell from 179 to 157, and has since then† varied between the limits of 163 and 153.

183. Thus, treating the statistics in the most generalised way and disregarding minor movements, it is observable that:—

(i) During eighteen months, while the rupee was worth about 1*s.* 3*d.* gold, the rupee price level ranged round a mean of about 176.

(ii) In the succeeding year, while the rupee was rising to 1*s.* 6*d.* gold, the rupee price level fell below 160.

(iii) Since then, while the rupee has remained, or been held, at about 1*s.* 6*d.* gold, the rupee price level has ranged round a mean of about 158, with a recent tendency to fall in sympathy with world prices.

The level of world gold prices, as indicated by the wholesale price index figures of the United States and the United Kingdom, was (in spite of intermediate fluctuations) approximately the same at the beginning of period (i) and at the end of period (iii).

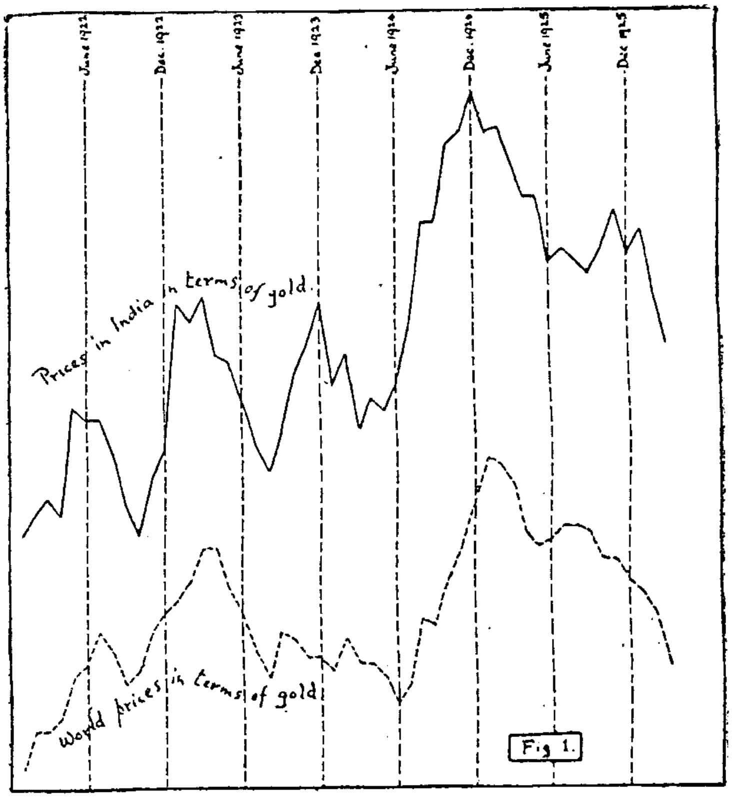
It is natural to conclude that, during the period of change, there was a mutual adjustment of prices and exchange, and that a substantial equilibrium was attained about the middle of 1925 and has been since maintained.

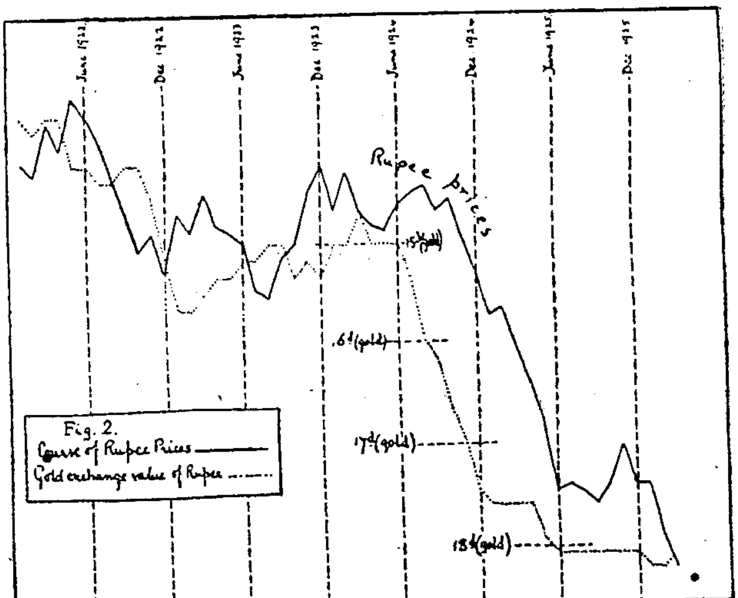
184. The nature and extent of the tendency towards adjustment may perhaps be more readily apprehended by means of a graphic representation. In the attached diagrams, in which an attempt has been made to exemplify general tendencies and minimise the effect of local variations, attention is directed to the comparative slopes and movements and not to the actual levels of the respective lines. The latter, as already pointed out, may be influenced by factors (*e.g.*, the base year chosen for the compilation of index numbers) which are largely irrelevant for the present purpose, whereas the general trend of movement would remain the same whatever basis were chosen for the figures.

185. In Figure 1 are shown two lines representing respectively the course of prices in India converted into gold prices on the basis of the current market rates of exchange, and the course of world prices in terms of gold. In the case of India the average between the Calcutta and Bombay figures of wholesale

* The trend of the Bombay index figure is similar.

† The statistics quoted in this and the following paragraphs are carried down to March, 1926, the latest month in respect of which complete data are, at the time of writing, available.





In figure 2, to facilitate comparison between the slopes of the two curves, the graph of the exchange value is inverted; *i.e.*, an upward slope represents a fall in exchange, and a downward slope a rise in exchange.

prices has been used, while the figure for world prices has been obtained by averaging the wholesale index numbers of the United States (Bureau of Labour) and the United Kingdom (Board of Trade) after correcting the latter for any variation of sterling from gold parity. In Figure 2 is shown the course of Indian prices in terms of rupees, i.e., actual prices in Calcutta and Bombay; together with this is plotted, for purposes of easy reference, the course of the gold exchange value of the rupee.

186. It will be seen that in 1923 and the first half of 1924, when the exchange was fairly steady at about 1*s*. 3*d*. gold, movements of world prices and of Indian rupee prices roughly corresponded, but from October 1924 to September 1925 there was a rapid and violent downward movement of the rupee price level which was not the reflection of any similar movement in world prices. The line representing Indian prices *in terms of gold*, however, continued to follow approximately the same trend as world prices, thus indicating that the fall of rupee prices was due to the adjustment of these prices to a new level of exchange.

187. An inspection of the diagrams suggests some interesting inferences as to the nature, pace and extent of the inter-adjustments between prices and exchange during the period (from the middle of 1924 to the middle of 1925) when the rupee was rising from 15*d*. gold to 18*d*. gold. Although it was not until the end of that period that 18*d*. gold was definitely attained, it has to be remembered that the greater part of the rise took place in the first half of the period, i.e., during the last six months of 1924. During that half-year the rupee rose approximately from 15*d*. gold to 17·6*d*. gold. World prices rose sharply from July 1924 to February 1925 and then receded gradually; by June 1925 they had come back to the level at which they stood in November 1924. Rupee prices remained nearly stationary from July to October 1924, and then, as pointed out above, a rapid fall set in. The only reasonable explanation of these divergencies between the course of rupee prices and that of world prices is the concurrent rise in exchange. The effect on rupee prices of this rise in exchange was not fully apparent at the outset, owing no doubt to the usual lag in such adjustments; it was sufficient immediately to check the rise in rupee prices, but it took a few months to overcome the inertia of those prices and produce a decided fall. When once the fall had set in it continued with practically equal rapidity throughout the first six months of 1925, although, as already observed, exchange at this period was rising at a much less rapid rate; in fact it only rose during these six months from 17·6*d*. gold to 18*d*. gold. The lag due to economic friction was then exerting its influence in the opposite direction, that is, it was tending to keep prices falling at the same pace although the impetus which started the fall had

lost much of its force. The conclusion seems almost irresistible that the marked fall in rupee prices in the first half of 1925 represented largely the tendency of those prices to adjust themselves to the rise in exchange, the greater part of which had occurred in the preceding half-year. This conclusion is strikingly illustrated by the parallel course of the lines in Figure 2 and is borne out by the course of prices in recent months, when with a steady exchange both rupee and world prices have been falling, practically in unison. The final curves in the diagrams suggest that the adjustment of internal prices in India to the 1*s*. 6*d*. rate of exchange is practically complete and that the trend of rupee prices has again begun to correspond with that of world gold prices.

188. This analysis appears to provide a conclusive answer to the main contention of those who doubt whether any substantial adjustment has yet taken place. That contention may be broadly stated as follows: "It was not till June 1925, that the rupee attained 18*d*. gold. Since that date rupee prices have been practically stable in relation to world prices. Therefore adjustment has not taken place and is still to come." The answer is that although the rupee did not definitely reach 18*d*. gold till June 1925, it had between July 1924 and January 1925 already traversed more than 80 per cent. of its upward journey from 15*d*. to 18*d*. gold; and that before June 1925 there had already taken place a heavy fall in rupee prices in relation to world prices, which may be regarded as the complement of the steep rise in exchange.

189. A further indication of equilibrium between internal and external prices during the last twelve months is to be found in the steadiness of exchange. Exchange is the mechanism by which differences in these two price levels are adjusted, and by which they are, as it were, kept in gear. When exchange remains steady over a fairly long period it may ordinarily be inferred that there are no differences to be adjusted. It has been urged against this view that exchange has only been kept at 1*s*. 6*d*. by Government manipulation, but in fact the so-called manipulation has been confined to an addition of 9 crores to the note circulation during the recent busy season and a withdrawal of 8 crores at the end of it. Such an amount of expansion and contraction is by no means excessive and is contemplated in the Indian Paper Currency Act as a normal seasonal variation. The fact that advantage has not been taken of the offer made by the Government in April last to sell sterling at 1*s*. $5\frac{3}{4}$*d*. goes to show that the present volume of currency is adjusted to the 1*s*. 6*d*. ratio.

190. It is relevant also to consider the course of India's foreign trade, which would naturally be affected by any disequilibrium between internal and external prices. If the rupee

were either under-valued or over-valued internally in comparison with the external value, either exports or imports would be subjected to a handicap which we should expect to see reflected in adverse conditions in the general trade of the country. As a matter of fact, while there are individual trades which are passing through a period of adversity, the general trade of the country, taken as a whole, shows no signs of the imposition of such a handicap.

191. All the above considerations point to the same conclusion, viz., that after twelve months of the 1*s*. 6*d*. rate of exchange, substantial adjustment of prices has been attained; and this conclusion is borne out by the experience of other countries which have recently stabilised their exchanges.

Wages.

192. We turn now to the question whether wages in India are in adjustment with the present level of prices and exchange. The material available is even less extensive and reliable than that relating to prices. But it may be inferred on general grounds that considerable progress has already been made in the process of adjustment. Prices are bound to react on wages sooner or later all the world over, and, although the effect may take longer to manifest itself in India than in countries where industry is more highly organised, the economic tendency none the less exerts its force in the same direction. In India a much larger percentage of wages is spent on foodstuffs than in western countries, and therefore there is a very necessary ultimate adjustment of wages to the price of food grains. This has been obscured for the time by the abrupt and belated rise of wages which the last decade has seen—a rise which was to some extent accelerated by factors not purely economic.

Where exchange and prices have been steady over a considerable period, we should feel justified in assuming that wages were in adjustment unless there were any clear indications to the contrary. The statistics of foreign trade afford no such contrary indication, but rather strengthen the assumption. Agriculture, which is pre-eminently India's greatest industry, has suffered from the world-wide effect of the war, which has been to leave the prices of agricultural produce at a lower level in relation to manufactured articles. This effect is illustrated by the marked difference between the average rise since 1914 in the prices of the articles that India exports, which are mostly agricultural, and the rise in the prices of imported articles, which are mostly manufactured. The rise has been considerably greater in the latter case than in the former, and this undoubtedly constitutes an economic loss to India. But it is a loss which she shares with all other agricultural countries and which cannot be made good by any monetary policy. In spite of this disadvantage such figures as are available (e.g., the index numbers of agricultural wages in rural areas compiled by the Labour Office, Bombay) indicate a general tendency to improvement in the wages of the labourer, and this tendency may be expected to facilitate adjustment to falling prices, which indeed operate as a check to the rising tide of wages. A similar phenomenon has been observed in the case of Government services, where the increase in the value of the rupee to 1*s.* 6*d.* has enabled Government to refuse increases of pay which it might otherwise have been difficult to resist.

193. On the whole we see no reason to believe that there is any general maladjustment in agricultural wages. Neither have we been able to discover any such condition in the wages paid by manufacturing industries generally. The Jute mill industry of Bengal granted temporary increases of pay to its employés in the years when prices were abnormally high, but as a result of the adjustments which have taken place the wages now paid in that industry are in line with to-day's price levels and cost of living. We found certain other important industries in a state of depression, notably the steel and cotton mill industries. The steel industry is suffering, not so much from high wages, as from the stress of foreign competition, stimulated in some countries, e.g. Belgium, by depreciating exchanges. With regard to steel and other industries, it appears to us that relief, if relief is really required, cannot properly be obtained by manipulation of the currency. The cotton mill industry of the Bombay Presidency has furnished us with detailed figures illustrating its difficulties. The chairman of the Bombay Millowners' Association told us that the present index figure of wages of mill-hands is 231 (as compared with 100 in 1914), and that attempts to reduce wages have been frustrated by strikes. This, too, in spite of the fact that the Bombay index numbers of wholesale prices, retail food prices, and cost of living are only 150, 150, and 153 respectively. These figures indicate that either the pre-war rate of wage was too low or the present rate is excessive. The reduction of the exchange rate to 1*s.* 4*d.*, which the chairman of the Association and many other witnesses advocated, would at best provide a temporary alleviation only for so serious a maladjustment. The ultimate effect would merely be, by inflating the currency to the extent of 12½ per cent., to produce a concealed reduction in wages of an equivalent percentage. Even if this would secure the desired equilibrium, which seems highly improbable, we do not regard it as sound policy to use the currency as a lever to reduce real wages. Any adjustment of wages thus brought about would be arbitrary in extent as well as temporary in character. Inflation is a dangerous expedient, which has often been advocated, and

sometimes deliberately applied, in other countries for similar purposes, but it has always been found to carry nothing but evils in its train. The prosperity of an industry depends on the soundness of its internal economy and its adaptability to changing conditions; and any basic unsoundness in its economic conditions cannot be rectified by a mere change in the ratio of exchange.

Effect on contracts.

194. In addition to prices and wages it is relevant to consider how outstanding contracts will be affected by the rate at which it is proposed to stabilise exchange. It has been represented to us that land revenue and other long term contracts were settled when exchange was at 1*s*. 4*d*. It is true that many of the current land revenue settlements were made during that period because generally speaking the normal term of these settlements is 30 years; but in view of the great rise in prices since 1914 the real incidence of land revenue, measured in terms of commodities, has been very materially lightened, and we cannot regard a 1*s*. 6*d*. rate as constituting a hardship in this respect.

195. With regard to other long term contracts, it must be remembered that the Indian exchange has been in a more or less unstable condition for the last 8 or 9 years. If regard is had to the gold exchange value of the rupee (computed, during the period of sterling depreciation, by a combination of the rupee-sterling and dollar-sterling exchanges) it will be seen that the rate broke away from 1*s*. 4*d*. gold in an upward direction in 1917 and continued to rise until February 1920, when it touched 2*s*. gold. It then fell away very rapidly to 11½*d*. gold in August 1921, and from that time rose until, in June 1925, it reached 1*s*. 6*d*. gold. It has since remained at about that figure. During the whole of this period of 8½ years the rate has been at or about 1*s*. 4*d*. for short periods only and has certainly never remained long enough at that figure for conditions to have been able to be readjusted on the basis of the old rate. It cannot be contended that contracts and arrangements concluded prior to 1918, and still existent, bulk more largely in the economic life of the country than those concluded during the subsequent 8½ years, during which period the exchange has been in a state of flux.

196. After the prolonged disturbances which have taken place, it is impossible to do absolute justice to the long-term debtor and creditor by fixing on any particular rate of exchange. In any case these long-term debts form only a small part of the total contracts outstanding. The great bulk of the contractual obligations incurred under modern conditions consists of short-term contracts, and so far as these short-term contracts are concerned, it is reasonable to suppose that they originated, for the most part, when conditions were based on the 1*s*. 6*d*. rate, or in any event after exchange had broken away from 1*s*. 4*d*.

We conclude therefore that from the point of view of contracts, as well as from that of prices and wages, the least disturbance will be caused, and the least injury will be done to all the interests concerned, by adhering to the *de facto* rate.

Arguments for reversion to 1s. 4d.

197. The only other rate which has been seriously advocated by many of our witnesses is 1*s*. 4*d*. This has been described to us as the "natural" rate for the rupee, but we have not been able to ascertain exactly what is meant by that term. Fluctuations in exchange are produced by the mutual interaction of internal and external prices, and as the level of internal prices is determined mainly by the volume of internal currency, the only rate which can properly be regarded as natural is the figure at which these prices are in adjustment with the existing volume of currency and are also in equilibrium with external prices. From this point of view 1*s*. 6*d*. appears to be clearly the "natural" rate under present conditions. The term, however, appears to be loosely used to denote the rate which would result if no attempt were made either by statutory enactment or executive action to anchor the rupee at a particular point. If such a policy were adopted, there can be no doubt that in a country like India where there are wide seasonable fluctuations of trade there would be similarly extensive fluctuations in the rate of exchange amidst which it would be impossible to distinguish any particular rate as "natural."

198. In this connection we have received criticisms of the action of Government in intervening in April 1926 to prevent a fall of exchange below 1*s*. $5\frac{3}{4}d.$, though no exception has been taken to the earlier action of the Government, in October 1925 in intervening to prevent a rise in exchange above 1*s*. $6\frac{3}{16}d.$ As a matter of fact if either of these tendencies was a natural one (i.e., the genuine reflection of trade conditions) it was the earlier tendency to rise above the 1*s*. 6*d*. upper gold point. That is evidenced by the fact that the rate was only kept down by large purchases of sterling and the accompanying expansion of the currency, whereas on the later occasion it has been authoritatively stated that the falling tendency was due not to any genuine trade factors but largely to speculation on the possibility of a lower rate than 1*s*. 6*d*. being recommended in our report. This statement is to some extent confirmed by the fact that the mere offer of reverse remittance at the 1*s*. 6*d*. lower gold point, coupled with a contraction of the currency by an amount nearly equivalent to that which was let out at the beginning of the busy season, was sufficient to check the fall, and no reverse councils were actually applied for.

199. One of the arguments frequently urged against the retention of the 1*s*. 6*d*. rate may be analysed as follows. Granted

that the *de facto* rate has been in operation for a considerable time and that prices and other conditions may have become adjusted to it, nevertheless it is urged that the rate came into being through Government manipulation of the currency, and it is suggested that a rate so established can be disturbed with less harmful results than would follow from the disturbance of a rate which has been produced by the interplay of purely commercial forces. This argument has only to be thus clearly stated to be seen to be fallacious. If it were true that the Government of India, as currency authority, were in error in pursuing a policy which resulted in the holding of the rupee at 1*s.* 6*d.*, it would be justifiable to criticise such error, but it would still remain true that, in choosing a rate for the final stabilisation of the rupee, it is the facts of the present that must be faced. When prices and other conditions are in adjustment with those in the world at large on the basis of an existent exchange rate, the question of the means by which that rate came into existence has no bearing on the extent or violence of the economic disturbances which would result from an alteration in the rate.

200. It has been suggested in favour of the 1*s.* 4*d.* rate that it would reduce the total demand for gold in connection with the introduction of a gold standard; and, further, that we have to envisage the possibility of a failure of the monsoon requiring the utilisation of the gold and sterling reserves of Government to support exchange, and that the rate of 1*s.* 4*d.* would be easier to maintain than 1*s.* 6*d.* The first contention overlooks the fact that a reduction in the gold value of the monetary unit by $12\frac{1}{2}$ per cent. involves of necessity an increase of the circulation by a similar percentage. The amount of gold in reserve required to support the circulation would therefore be the same in either case. As regards the second suggestion, provided that the gold and gold securities reserves are sufficient to prevent their exhaustion before the necessary contraction of the rupee circulation has been brought about, we see no ground for thinking that, with the establishment of a central currency and banking authority, with full power to make its credit policy effective, it will be more difficult to maintain exchange at 1*s.* 6*d.* than at 1*s.* 4*d.* The proviso is satisfied by the constitution of reserves recommended elsewhere.

201. When once exchange has been stabilised and prices and other conditions are fully ajdusted to the rate chosen, it is of course true that the testing time for the mechanism that maintains the exchange will come if and when there is a succession of bad monsoons. But that testing time will come equally whether the rate of stabilisation be 1*s.* 6*d.* or 1*s.* 4*d.* or any other rate; and the ability to meet it will depend, not on the

figure at which exchange is fixed, but, as indicated above, on the maintenance, and proper utilisation, of adequate gold reserves.

202. It has been suggested that competition from foreign countries with depreciated or depreciating currencies, such as France and Beglium, could be met by lowering the Indian exchange to 1*s*. 4*d*. When once these currencies have been stabilised, the adoption by India of a ratio of 1*s*. 4*d*. rather than 1*s*. 6*d*. would not leave her in any better position to meet such competition. During the transition period, when the foreign currencies are unstable, the remedy, if any, must rather be sought elsewhere than in the manipulation of her currency policy. If it should happen that any of the other countries concerned avoid stabilisation, and allow their currencies to depreciate continuously, it will scarcely be suggested that India should enter on a course of competitive inflation in order to keep pace with them.

203. The rate of 1*s*. 4*d*. has also been supported on the ground that the recent abnormal absorption of gold by India has been due to the cheapness of gold brought about by the rise in exchange, and that there will be a wholesome check to this absorption if the rupee price of gold is raised by lowering the gold value of the monetary unit. It was stated in evidence before us, by a leading bullion broker, that whatever the rate of exchange, India must buy, has bought, and will continue to buy gold; and that she can never saturated with gold, and will only stop buying it when her production falls off through famine or other causes. It is true that gold has in recent times been relatively cheap compared with other commodities, but it is evident that, since a change in the gold value of the rupee must involve a corresponding change in the rupee prices of commodities, the mere lowering of the ratio of the rupee cannot result in more than a temporary alteration in the relative cheapness of gold and general commodities. The suggestion that India's appetite for gold can be cured by a lowering of the exchange is indeed based on an imperfect apprehension of her economic circumstances. The only sure way to eradicate this wasteful habit is to stabilise the currency, establish confidence in its stability, educate people in the habit of investment, and extend banking facilities.

204. Another argument advanced in support of a reversion to the pre-war rate is that there is likely to be a fall of world gold prices in the near future, and that the fixation of exchange at 1*s*. 6*d*. will accentuate the fall in India, and make it specially embarrassing, as was the rapid fall which took place in 1920, when the ill-fated attempt to stabilise Indian exchange at 2*s*. was made. The economic conditions of to-day are very different from those prevailing in 1920. The fall in prices that occurred

in that year was quite abnormal both in rapidity and in extent. It was an aftermath of a world-wide upheaval, a reaction from the enormous expansion of credit that took place during the war. It would be imprudent to base a currency policy on the supposition that such conditions are likely to recur, because a second upheaval of the kind would overwhelm almost all currency systems in a common ruin. If we aim at stability we must assume that the period of catastrophic disturbance is over and that future movements of prices will proceed on more normal lines. If the world's gold production in the future should fail to keep pace with the demand, a period of falling prices would probably set in, but, judging from past experience, the price movement due to such a cause would be slow and gradual, and should not prove a menace to the stability of the rupee. India might no doubt suffer, with the rest of the world, from a long period of trade depression, but that is a risk which she cannot escape if she adopts, and adheres to, a gold standard. Moreover, it is a risk to which she will be equally subject whether she stabilises her exchange at 1*s*. 6*d*. or at 1*s*. 4*d*.

205. Broadly speaking, the arguments which have been brought forward to prove that a reversion to 1*s*. 4*d*. would be beneficial, merely show that, during a period of adjustment of conditions to that rate, certain sections of the community (e.g., debtors, exporters, and employers of labour) would be benefited at the expense of certain other sections (*e.g.* creditors, importers, and wage-earners); they do not show that there would be any substantial permanent benefit even to any section at the expense of another, still less to the country as a whole.

Economic effects of a reversion to 1*s*. 4*d*.

206. On the other hand, the change would produce a profound disturbance in economic conditions throughout India. Even if our view that prices and wages have been substantially adjusted to the 1*s*. 6*d*. rate is challenged, it cannot be seriously contended that they are in any way adjusted to a rate of 1*s*. 4*d*. As we have already pointed out, it is more than 8 years since that rate was in stable operation, and, in view of the wide fluctuations that took place between 1917 and 1925, is seems clear that the only rate to which there can be any degree of adjustment is 1*s*. 6*d*. In so far as this adjustment has taken place—and we have given our reasons for believing that it is practically complete—a reduction of rate of exchange to 1*s*. 4*d*. would produce a general rise of prices of 12½ per cent., a change which would be severely felt by consumers generally and especially by the poorer paid members of the literate classes. The adoption of a 1*s*. 4*d*. rate would result in an arbitrary reduction of the real wages of labour; and for the infliction of such a hardship we can see no justifica-

tion in equity or in expediency, in the interests of the classes directly affected, or of the community as a whole.

The effect of the change on foreign trade would be immediate and for a time convulsive. No one acquainted with the practical working of the exchange market can suppose that, once a policy of reversion to a lower rate had been announced, there would result merely a gradual and steady decline to that rate. There is always a considerable amount of latent demand for remittance to England, and, if the decision to adopt a lower rate were announced, remitters would at once endeavour to obtain the best price for rupees which they could get until the rate announced were reached. The tide would then turn the other way and there would be a very large demand for rupees at the new rate. This would have to be met by an offer to buy exchange without limit at the gold import point, thereby making additions to currency. This might possibly lead to a series of violent fluctuations before exchange settled down at the new lower rate. Whether such fluctuations took place or not, the sudden fall in exchange might easily create a boom which would be followed later by a slump.

Effect on public finances.

207. Some evidence has been put before us as to the effect which would be produced on the Government finances by a reversion to 1*s*. 4*d*. We do not regard this as a decisive factor; but we cannot ignore the fact that a reversion to 1*s*. 4*d*. would inevitably lead to increases in both Central and Provincial taxation and would probably also result in a postponement of further remissions of the Provincial contributions to Central revenues, and a setback to the development of nation-building projects in the Provinces.

208. As to the finances of the Government of India, the Budget is now based on an exchange rate of 1*s*. 6*d*. to the rupee. If exchange were lowered to 1*s*. 4*d*. it would no doubt be possible ultimately to make adjustments (including the grading-up of taxation in accordance with the decreased value of the rupee) which would enable the Government to meet its liabilities without any increase in the real burden of taxation. Nevertheless, the immediate effect on the Budget would be considerable. The financial authorities in India have estimated that, on the basis of the 1925-26 Budget, the net sterling expenditure of the Government of India would be at once increased by about three crores per annum. There would be a similar immediate increase in the railway expenditure. Although railway finances have been separated from general finances, the effect of a lowering of the exchange rate would be to require either an increase in rates and fares or a revision of the terms of the Railway Contribution; so that the whole or part of this further increase might well become

a charge on the general budget. There would be some extra expenditure on stores purchased in India, and some readjustment might have to be made in salaries of Government servants who would be affected by the increased cost of living. Some portion of the increased expenditure would no doubt be met from the increase in Customs revenue from such articles as are assessed on an *ad valorem* basis. This on a rough calculation, making some allowance for decrease in the volume of imports, would not exceed 2 crores. No estimate can be framed of any increased yield which might eventually be had from Taxes on Income. What is clear is that the immediate loss from the standpoint of public finance would be considerable and would require to be made up by increases in taxation, if the Budget were to be balanced, and by still further increases, if further reductions in the Provincial contributions or in existing forms of taxation were to be made.

209. A significant circumstance is the recent successful issue by the Government of India of a long term loan of Rs. 25 crores at 4 per cent. at a price of Rs. 88 per cent. That it is possible for India to borrow at a rate which compares favourably with the rate at which the most advanced countries can borrow at present is a matter of congratulation, and shows how high the financial credit of India stands. This improved position is based on the balancing of the Indian budget. A reversion to the 1*s*. 4*d*. ratio, by the very adverse effect which it would have on the budgetary equilibrium, would necessarily impair the credit of India as regards borrowing.

210. The effect on Proivncial finances of lowering the rate to 1*s*. 4*d*. has been well described as follows by the Government of Madras:—

"Any policy adopted as a result of the recommendations of the Royal Commission may vitally affect the Government of Madras as a Local Government. The alteration in the level of prices which resulted from the war subjected their finances to a strain from which they have not yet fully recovered. The necessity for a revision of salaries was becoming evident even before the outbreak of the war, and during its course cases in which relief was most urgently called for were met by a series of expedients which were purely temporary in character. On the conclusion of the war a comprehensive measure of revision had to be undertaken, and the burdens thus imposed on the revenues of the Presidency were so great as to neutralise any benefit it received from the financial settlement in connection with the Reforms. The full liabilities which this revision of salaries imposed have not even now been liquidated, and only the fact that the considerable measure of stability in prices which has prevailed of late has rendered any further general measure of revision unnecessary has enabled the Madras Government to meet the annual increase in its establishment and pension charges. If, as a result of changes in currency policy, a further rise in prices were to render a revision of salaries again necessary, the revenues of the Local Government would become inadequate to the strain, and the levying of additional taxation for improving the salaries of Government servants at the cost of the taxpayer, who would himself be affected by the rise in prices, would cause widespread discontent. This would be accompanied by a new period of readjustment of agricultural and industrial wages with all the dangers and unsettlement which that involves. The Madras Government trust, therefore, that theoretical arguments will not be allowed to obscure a practical issue to which they attach great importance."

Miscellaneous considerations.

211. We have referred in an earlier part of our Report to the difficulty of keeping the silver rupee in circulation if the price of silver were to rise above the melting point of the coin. With the rupee at 1*s*. 4*d*. the melting point would be reached if the price rose to approximately 43*d*. per standard ounce in London: with a 1*s*. 6*d*. rate the melting point would be at about 48*d*. per ounce. From the evidence that we have received as to the present state and future prospects of the silver market, it seems improbable that either of these levels will be reached for many years; but, as we have observed in paragraph 45, the future of the market is shrouded in obscurity, and in framing our proposals for reform of the currency system, we have deemed it prudent to envisage the possibility of a material rise in the price of silver at some future time. If such a rise should take place, it is obvious that a 1*s*. 6*d*. rate of exchange will provide a wider margin of safety than 1*s*. 4*d*., and though an insurance of this kind will not, in view of our recommendation as to the status of the note, be any longer a decisive consideration, it constitutes an advantage on the side of the 1*s*. 6*d*. rate.

212. There is one minor respect in which an advantage is claimed for the 1*s*. 4*d*. rate. At that rate of exchange the sovereign is equivalent to precisely 15 rupees, whereas at 1*s*. 6*d*. the value of the sovereign in Indian currency is Rs. 13 as. 5 ps. 4, a sum which would be very inconvenient if the sovereign were to circulate as money. This objection, however, will lose much of its force if the legal tender character of the sovereign is removed, and it will hold good only in regard to accounting, where the 1*s*. 6*d*. rate will involve a recurring decimal in the conversion of pounds into rupees. Even this objection is not as strong as it appears at first sight, because a crore of rupees will be exactly three-quarters of a million pounds. We have been told by Government witnesses that for their accounting purposes 1*s*. 6*d*. is not at all

inconvenient. The same is true in respect of commercial transactions. On the whole, therefore, the balance of convenience from the point of view of accounts seems to be about equal.

Conclusion.

213. The combined weight of all the above arguments leaves no doubt in our minds as to the right course. It brings us to the conclusion, as already indicated, that the rupee should be stabilised in relation to gold at the existing rate of 1*s*. 6*d*. The opportunity for reversion to the historic rate of 1*s*. 4*d*., if it ever existed, is gone; and the best interests of India as a whole now require that stability should be achieved without producing those disturbances which would be the inevitable consequence of adopting any rate but that which is current.

V.—MISCELLANEOUS RECOMMENDATIONS.

Means to promote banking development.

214. Reference has already been made to the importance of developing banking and investment facilities, and of finding means to encourage the people of India to divert their savings to profitable channels of investment. It does not fall within our terms of reference to suggest in detail all the measures which may be taken to this end. But, since the smooth working of a system of currency cannot but be impeded by the existence of large stores of currency in hoards, it is proper for us to urge, and we do urge emphatically, that nothing should be left undone which will tend to facilitate and encourage banking progress in India.

215. We are impressed by the great and growing activities of the Imperial Bank in the direction of the extension of up-country banking. We note with interest the recommendations on the subject of extension of banking facilities which have been made by the External Capital Committee. We should welcome any steps which can be taken in the direction of making an extensive and scientific survey of banking conditions in India. In any scheme of banking reform that may be planned, we trust that due emphasis will be laid on the provision and extension of cheap facilities to the public, including banks and bankers, for internal remittance.

216. Of the other measures which are understood to be under consideration, one which appears to us likely to be particularly fruitful is the abolition of the present stamp duty on cheques. This charge is undoubtedly an obstacle in the way of the development of banking in the country. It probably tends to restrain many people from opening current accounts and so making pay-

ment by cheque instead of cash. A similar duty was at one time in force in the United States of America. It was found to be an unsatisfactory restraint upon the use of cheques and upon economy in the use of currency, and was abandoned. The abolition of the duty in India would hold out some prospect of a ready and wide adoption in the bazaars of cheques as a means of payment. This would be an appreciable step forward in the development of banking, and might well prove an important factor in bringing about a profound and still more widespread change in the economic habits of the masses.

Improvement of statistical material.

217. We have already taken occasion to remark on the absence of reliable and scientifically constructed statistics of prices and wages, and to recommend that these should be improved. The possession and utilisation of a reliable and reasonably complete body of satistical *data* is an essential of a sound currency system, and this is especially the case in a country like India where conditions vary so greatly in different parts of the country. It would be regrettable if the Reserve Bank should, at its inception, be handicapped by the absence of such an important aid to its activities as would be furnished by a full body of statistics.

VI.—PROCEEDINGS OF THE COMMISSION.

218. We first assembled at Delhi on the 23rd November, 1925, and we took evidence there, at Bombay and at Calcutta. We held in India 50 meetings and orally examined 46 witnesses. Amongst these were the representatives of 9 Chambers of Commerce. We concluded our sittings in India on the 8th January, 1926, and reassembled in London on the 1st March, where we heard evidence until the 12th May. We held in London over 50 meetings and orally examined 17 witnesses.

219. We wish to record our high appreciation of the ready assistance and helpful co-operation which we have received from all witnesses in India and in England, many of whom attended at considerable inconvenience to themselves. To the eminent foreign experts who have assisted us we express our particular thanks. We were fortunate in being able to hear, in London, distinguished authorities from the United States, who came over expressly to assist us, and we have received written evidence from others. To them our special thanks are due.

220. The record of oral evidence, a number of written statements of evidence, and other relevant documents, are issued

separately. The number of written statements of evidence received was over 135. Considerations of convenience and economy have precluded the inclusion in the published volumes of the whole of this material.

VII.—SUMMARY OF RECOMMENDATIONS.

221. (i) The ordinary medium of circulation should remain the currency note and the silver rupee, and the stability of the currency in terms of gold should be secured by making the currency directly convertible into gold, but gold should not circulate as money. (Paragraph 54.)

(ii) The necessity of unity of policy in the control of currency and credit for the achievement of monetary stability involves the establishment of a Central Banking system. (Paragraphs 83-85.)

(iii) The Central Banking functions should be entrusted to a new organisation, referred to as the Reserve Bank. (Paragraphs 89, 90.)

(iv) Detailed recommendations are made as to the constitution (paragraphs 91-102) and functions and capacities of the Bank. (Paragraphs 139-164.)

(v) The outlines of a proposed charter are recommended to give effect to the recommendations which concern the Reserve Bank. (Paragraphs 139-164.)

(vi) Subject to the payment of limited dividends and the building up of suitable reserve funds, the balance of the profits of the Reserve Bank should be paid over to the Government. (Paragraphs 99, 100.)

(vii) The Bank should be given the sole right of note issue for a period of (say) 25 years. Not later than five years from the date of the charter becoming operative, Government notes should cease to be legal tender except at Government Treasuries. (Paragraph 141.)

(viii) The notes of the Bank should be full legal tender, and should be guaranteed by Government. The form and material of the note should be subject to the approval of the Governor-General in Council. A suggestion is made as to the form of the note. (Paragraphs 138, 149, 155.)

(ix) An obligation should be imposed by statute on the Bank to buy and sell gold without limit at rates determined with reference to a fixed gold parity of the rupee but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purpose for which the gold is required. (Paragraphs 59-61, 150, 151.)

(x) The conditions which are to govern the sale of gold by the Bank should be so framed as to free it in normal circumstances from the task of supplying gold for non-monetary purposes. The method by which this may be secured is suggested. (Paragraphs 64, 150.)

(xi) The legal tender quality of the sovereign and the half-sovereign should be removed. (Paragraphs 65, 66.)

(xii) Government should offer "on tap" savings certificates redeemable in 3 or 5 years in legal tender money or gold at the option of the holder. (Paragraphs 67, 68.)

(xiii) The paper currency should cease to be convertible by law into silver coin. It should, however, be the duty of the Bank to maintain the free interchangeability of the different forms of legal tender currency, and of the Government to supply coin to the Bank on demand. (Paragraphs 69-71, 152.)

(xiv) One-rupee notes should be re-introduced and should be full legal tender. (Paragraph 72.)

(xv) Notes other than the one-rupee note should be legally convertible into legal tender money, i.e., into notes of smaller denominations or silver rupees at the option of the currency authority. (Paragraphs 73.)

(xvi) No change should be made in the legal tender character of the silver rupee. (Paragraph 74.)

(xvii) The Paper Currency and Gold Standard Reserves should be amalgamated, and the proportions and composition of the combined Reserve should be fixed by statute. (Paragraphs 75-77.)

(xviii) The proportional reserve system should be adopted. Gold and gold securities should form not less than 40 per cent. of the Reserve, subject to a possible temporary reduction, with the consent of Government, on payment of a tax. The currency auhtority should strive to work to a reserve ratio of 50 to 60 per cent. The gold holding should be raised to 20 per cent. of the Reserve as soon as possible and to 25 per cent. within 10 years. During this period no favourable opportunity of fortifying the gold holding in the Reserve should be allowed to escape. Of the gold holding at least one-half should be held in India. (Paragraphs 78, 79, 131, 132, 153.)

(xix) The silver holding in the Reserve should be very substantially reduced during a transitional period of 10 years. (Paragraphs 80, 133-136, 145.)

(xx) The balance of the Reserve should be held in self-liquidating trade bills and Government of India securities. The "created" securities should be replaced by marketable securities within ten years. (Paragraphs 81, 116, 136, 145.)

(xxi) A figure of Rs. 50 crores has been fixed as the liability in respect of the contractibility of the rupee circulation. Recommendations are made to secure that an amount equal to one-fifth of the face value of any increase or decrease in the number of silver rupees in issue shall be added to or subtracted from this liability, and the balance of profit or loss shall accrue to or be borne by the Government revenues. (Paragraphs 82, 120-123, 146-148.)

(xxii) The Issue Department of the Reserve Bank should be kept wholly distinct from its Banking Department. (Paragraphs 137, 143.)

(xxiii) The Reserve Bank should be entrusted with all the remittance operations of the Government. The Secretary of State should furnish in advance periodical information as to his requirements. The Bank should be left free, at its discretion, to employ such method or methods of remittance as it may find conducive to smooth working. (Paragraphs 103-109, 111, 140.)

(xxiv) During the transition period the Government should publish a weekly return of remittances made. A trial should be made of the system of purchase by public tender in India. (Paragraph 110.)

(xxv) The cash balances of the Government (including any balances of the Government of India and of the Secretary of State outside India), as well as the banking reserves in India of all banks operating in India, should be centralised in the hands of the Reserve Bank. Section 23 of the Government of India Act should be amended accordingly. (Paragraphs 111, 112, 140, 161, 162.)

(xxvi) The transfer of Reserve assets should take place not later than 1st January, 1929, and the Bank's obligation to buy and sell gold should come into operation not later than 1st January, 1931. (Paragraph 165.)

(xxvii) During the transition period the currency authority (i.e., the Government until the transfer of Reserve assets and the Bank thereafter) should be under an obligation to buy gold and to sell gold or gold exchange at its option at the gold points of the exchange. This obligation should be embodied in statutory form, of which the outline is suggested. (Paragraph 166.)

(xxviii) Stabilisation of the rupee should be effected forthwith at a rate corresponding to an exchange rate of 1*s.* 6*d.* (Paragraphs 168-213.)

(xxix) The stamp duty on bills of exchange and cheques should be abolished. Bill forms, in the English language and the vernacular in parallel, should be on sale at post offices. (Paragraphs 116, 216.)

(xxx) Measures should be taken to promote the development of banking in India. (Paragraph 214.)

(xxxi) Every effort should be made to remedy the deficiencies in the existing body of statistical data. (Paragraph 217.)

222. Upon our joint Secretaries, Mr. G. H. Baxter, of the India Office, and Mr. A. Ayangar, of the Indian Finance Department, has fallen the burden of organising our prolonged enquiry in India and in London. Their task has been performed with signal industry and ability, and their labours deserve our cordial appreciation.

We much regret that we were deprived by ill health at an early period of our deliberations of the valuable services as Secretary of Mr. A. V. V. Aiyar, C.I.E., of the Indian Finance Deparment.

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223. The signatories of this Report other than Sir Purshotamdas Thakurdas desire to add the following observations with reference to matters dealt with by him in his note of dissent.

224. We do not accept the historical retrospect in the note of dissent, but we have deliberately refrained in our retrospect from a detailed survey of the merits or demerits of the management of the currency in India since the silver standard was abandoned, partly because most of the ground had already been traversed by our predecessors, but mainly because we do not consider that any useful purpose would be served by attempting to apportion praise or blame for what is past. Any such attempt would probably result in injustice because currency theory and practice have undergone a steady process of evolution during the last quarter of a century, and it would be unfair in the light of later experience to condemn steps or decisions which were taken before that experience was acquired. We have delved in the past merely to the extent necessary to prepare the ground for future growth. We will only add, with reference to the conclusion in paragraph 45 of the note of dissent, that we do not regard the Government or people of India as committed to the principles recommended by the Fowler Committee to any greater extent than they stand committed to the principles recommended by other committees which have been accepted and acted on. We were instructed in our terms of reference to consider whether any modifications in the Indian exchange and currency system are desirable in the interests of India, and we have held ourselves free to make any recommendations which appeared to us to be desirable in those interests, whether they accord or do not accord with principles previously accepted.

225. In paragraph 53 of the note it is said that "I am not aware that any other countries, with a gold standard, and a central bank as the currency authority, have found it necessary to demonetise their gold coin". We must point out that in countries with a gold bullion standard such as that which we recommend

gold coin is demonetised in fact. In Great Britain, for instance, although there is gold coin of legal tender there is no means by which it can be obtained as of right. The only gold which can be obtained as of right is gold in bars, which are not currency. Thus gold coin cannot pass into circulation. This is an essential feature of the gold bullion standard to secure the automatic expansion and contraction of currency.

226. It is suggested in that part of the dissenting note which deals with a Central Bank for India that no serious curtailment of the Imperial Bank's commercial banking activities need be feared if it were entrusted with the functions of a Central Bank. It is the unanimous opinion of the Commission that if the sole right of note issue were to be entrusted to the Imperial Bank its charter would have to be amended to conform precisely to the conditions which we recommend. A perusal of these and in particular of the business the Bank may and may not do (see Schedule II) sufficiently demonstrates that the limitations put upon its business would prevent it from transacting the every day commercial banking business of the country or from entering into competition with the commercial banks in any general sense. We cannot therefore associate ourselves with the view that no serious curtailment of the Imperial Bank's commercial banking activities need be apprehended if it were limited to the business which can properly be transacted by a Central Bank. Such a limitation of its functions would, as we have said, deprive India of an indispensable component of its banking organisation and would leave a gap which could not be filled for many years by the growth of other indigenous institutions. Neither do we concur in the view that the establishment of an entirely new Central Bank will either lead to competition between it and the Imperial Bank or leave the Central Bank without sufficient scope for the employment of its funds. The charter which we recommend will obviate the first objection, while the experience of newly established Central Banks in other countries does not support the second objection.

227. As to that part of the note of dissent in which a reversion to a 1*s*. 4*d*. rate of exchange is advocated, there is no argument therein advanced which did not receive our most careful consideration before we arrived at our conclusions. The case appears to us to be fully dealt with in the relevant section of the Report. As to that portion of our colleague's argument which is based upon figures and statistics it will be understood that the accuracy and the completeness of the figures have not the authority of the Commission. We do not agree either with the discrimination which has been exercised in their choice, or with the inferences and deductions which have been based thereon.

The whole note contains many statements and inferences with which we have not thought it necessary or even relevant to deal, but which we in no way accept.

E. HILTON YOUNG (*Chairman*).
R. N. MOOKERJEE.
NORCOT WARREN.
R. A. MANT.
M. B. DADABHOY.
HENRY STRAKOSCH.
ALEX. R. MURRAY.
PURSHOTAMDAS THAKURDAS.*
J. C. COYAJEE.
W. E. PRESTON.

G. H. BAXTER }
A. AYANGAR } *Secretaries.*

Dated the 1st day of July, 1926.

* Subject to the Minute of Dissent attached hereto.

ANNEXE.

SUMMARY OF THE SCHEME FOR A GOLD CURRENCY REFERRED TO IN PARAGRAPH 33 OF THE REPORT.

The scheme, which was placed before the Commission in evidence by the officials of the Finance Department of the Government of India, and which is set out in detail in Appendices 5 to 7 (Vol. II of Appendices), assumes the transfer of the management of the paper currency, and the conduct of the Government's remittance, to the Imperial Bank of India. The estimates and inferences are those of the authors of the scheme, and not of the Commission. Rupees are converted at 1*s*. 6*d*.

The eventual position would be:—

(*a*) Gold coin and bank notes to be unlimited legal tender, and silver rupees up to Rs. 50 only.

(*b*) A statutory obligation on Government to give gold coin in exchange for gold bullion.

(*c*) A statutory obligation on the Bank to buy gold.

(*d*) Bank notes to be payable on demand in gold coin.

(*e*) Constitution of the new Reserve to be:—

(*i*) Gold holding to be not less than 30 per cent., subject to reduction on payment of a tax.

(ii) Gold securities or sterling trade bills to be not less than 20 per cent.

(iii) Remaining investments to be Government of India securities (not more than 90 crores) and internal trade bills.

(*f*) The Bank to undertake to keep the Secretary of State supplied with funds to meet the sterling charges of Government.

The rupee cannot be limited as legal tender until an opportunity has been given for holders of rupees to convert them into gold. The magnitude of this liability is indeterminate, but it is assumed that Rs. 110 crores might be presented for conversion by the public. It would not be practicable to provide for the immediate conversion of such an amount; the following stages are accordingly suggested:—

(i) A statutory obligation on Government to sell gold bullion (in 400 oz. bars) at par, and to buy gold bullion at par less seignorage.

(ii) As soon as sufficient gold is available, a gold coin should be put into circulation, and offered as freely as resources permit, but without any definite obligation. (During these earlier stages it might be necessary to increase the supply of gold by external borrowing.)

(iii) After, say, five years, the liability to give gold coin in exchange for notes or rupees, and also for gold bullion on payment of seignorage, should be imposed.

(*iv*) After a further (say) five years the silver rupee should be made legal tender for sums up to a small fixed amount only (say, Rs. 50).

During the transition period, it is assumed that the total of gold and gold securities in the Reserve may be allowed to fall as low as 30 per cent.

The Government would have for disposal some 200 crores of silver rupees (110 crores presented for conversion, *plus* about 90 already in the Reserve). This quantity represents about 687 million fine ozs. of silver, *i.e.*, nearly three times the world's annual production. It would be necessary to spread the sales over a fairly long period. It is assumed, in estimating the cost of the scheme, that they might be spread evenly over a period of ten years. The average price obtained may be expected to be not less than 24*d*. per standard ounce.

The amount of gold required (on the basis of a note issue of 189½ crores) for introducing the scheme in all its stages would be: Rs. 27·2 crores additional for the Reserve, *plus* Rs. 110 crores for the conversion of rupees; total, Rs. 137·2 crores, or £103 millions.

It may be assumed that about £15 millions of gold would be required at the time of initiation of stage (i), a further £35 millions within a year, and the remaining £53 millions over a period of 10 years.

The cost of the scheme is estimated by its authors at about Rs. 1¾ crores per annum during the first five years and thereafter from two-thirds of a crore to 1·12 crore.

SCHEDULE I.

(PARAGRAPH 64 OF REPORT).

NOTE ON THE METHOD OF COMPUTING THE BUYING AND SELLING RATES FOR GOLD.

1. The circumstances in which gold flows out of and into a Central Bank, for purely monetary reasons, in a country which has adopted the gold bullion standard are as follows:—

> Gold will be withdrawn from the Central Bank only when the rate of exchange between the domestic currency and the currency of another gold standard country has reached a point at which it becomes profitable to individuals to ship it to the other country, sell it there to the currency authority at its statutory price and employ the proceeds for obtaining their domestic currency. On the other hand, gold will be sold to the Central Bank only when the rate of exchange between the domestic currency and the foreign currency has reached a point at which it becomes profitable to individuals to convert it into the foreign currency, to buy with it, from the foreign currency authority, gold at the statutory price, ship the gold to their own country, and there present it to the Central Bank for reconversion into the domestic currency. These conditions will be reached when the domestic currency varies from its par value by an amount equal to the cost of shipping it to or from the foreign gold centre.

2. This may conveniently be expressed as follows, using illustratively the particular case of rupees and sterling:—*

> Let x denote the number of rupees† required to buy in Bombay a telegraphic transfer on London for the sterling equivalent of one tola of fine gold.
>
> Let p denote, in rupees per tola of fine gold, the gold par value laid down for the rupee.
>
> Let n denote in rupees the cost (including packing, freight, insurance, and loss of interest in transit) of shipping one tola of fine gold from London to Bombay.

* For the purpose of this generalised statement, the small difference between the Bank of England's buying and selling prices for gold may be ignored.

† *I.e.*, the rate of exchange, here expressed in a somewhat unfamiliar manner in order to relate all the expressions to a given weight of fine gold.

Then gold will be withdrawn from the Central Bank, and shipped abroad, when

x is greater than $(p + n)$;

and gold will be imported, and sold to the Central Bank, when

x is less than $(p-n)$.

When x lies between $(p+n)$ and $(p-n)$, *i.e.*, when the rate of exchange lies between the " gold points," it is not profitable for individuals, *for purely monetary purposes*, to withdraw gold from the Bank or to import and sell it to the Bank.

3. It cannot be assumed that, in the case of India, gold movements can be confined to those for purely monetary purposes; unless, therefore, the Central Bank is relieved of the necessity of supplying gold within the two gold points of the exchange, it would be exposed to a constant drain upon its gold reserves for purposes other than those for which they are held. The gold and gold security reserves of a Central Note-Issuing Bank serve the purpose of rectifying a temporary disequilibrium in the balance of foreign payments. They are held to enable external obligations to be discharged pending an adjustment being achieved (by an appropriate credit policy) of the value of the currency to its parity with gold. The reserves exist to assure the maintenance at parity with gold of the purchasing power of the monetary unit, *i.e.*, to meet purely monetary needs. It is evident that, if they can be drawn upon in the ordinary course to satisfy non-monetary purposes to anything but a minor extent, the Bank's primary task, *viz.*, to maintain the external value of the currency, will be jeopardised. To avoid having its gold reserves depleted in these circumstances, and to replenish them when a drain occurs, the Bank has at its command but one weapon, that is credit control. It would have to follow a more or less permanent policy of so restricting the monetary circulation by a contraction of credit as to cause the rupee to appreciate beyond the upper gold point of the exchange. That is the only way in which gold can be attracted from abroad to make good the loss of reserves due to an internal drain. It is obvious that such a state of things would have highly injurious reactions on the internal economy of India, and should consequently be avoided.

4. London is undoubtedly the most convenient gold centre for India. Not only is the currency of Great Britain freely convertible into gold at statutory prices and exportable in that form, but there is also an extensive bullion market. London is India's clearing house for her foreign commercial and financial transactions, and the available means of communication are such as to assure the movement of gold to and from India to be less subject to uncertainties than would be the case if any other of the great gold centres were chosen.

In what follows it has therefore been assumed that London will be treated as the gold centre in relation to which the appropriate buying and selling rates for India will be calculated.

5. It is required so to frame the Bank's obligation to sell coin gold as to make it unprofitable for gold to be bought from it except in circumstances in which it would be profitable to do so for purely monetary purposes.

6. Reverting to the symbols employed in paragraph 2 above, the rupee equivalent of the price of gold in the gold centre (London) is x rupees per tola. So that, when $x = p + n$ (*i.e.*, the exchange is just within the gold points), the price of gold in London $= (p+n)$ rupees per tola. The cost of shipping being n rupees per tola, the cost of laying down in Bombay gold from London will then be $(p+2n)$ rupees per tola. It follows, that the lowest rate at which the Central Bank can safely sell gold, when exchange is within the gold points, is $(p+2n)$ rupees per tola, for delivery in Bombay, or $(p+n)$ rupees per tola, for delivery in London.

7. *Value of n.*—The following table gives the various elements that enter into the value of n, taking London as the foreign centre. (For purposes of comparison the corresponding figures for two other centres are also given.)

—	From London *ex* Bank of England or to London (Bank of England).	From South Africa *ex* Durban.	From New York *ex* Mint.
	Per cent. *s.* *d.*	Per cent. *s.* *d.*	Per cent. *s.* *d.*
Freight	15 0	12 6	10 0
Insurance	2 3	1 3	3 2·5
Packing, etc.	0 3	0 3	—
Mint charges	—	—	1 2·5
Bank charges	—	—	0 6
Total transport charges	17 6	14 0	14 11
Interest at 5 per cent. for period of transit, 21 days between London or Durban and Bombay and 35 days between New York and Bombay.	5 9	5 9	9 7

The cost of transport, *etc.*, expressed as a percentage of the cost of gold at the foreign centre, and taking London as the foreign centre, is thus 23*s.* 3*d.* per cent. = 1·1625 per cent.

8. *Buying rate for gold.*—

1 tola of fine gold = 180 grains of fine gold.

480 grains of fine gold = 1 oz. of fine gold.

1 oz. of fine gold = 84*s.* 11·45*d.* (price per fine oz. corresponding to Bank of England's selling price of 77*s.* 10·5*d.* per standard oz.).

1*s.* 6*d.* = 1 rupee (par of exchange).

$\therefore$ 1 tola of fine gold $= \dfrac{180 \times 84s.\ 11{\cdot}45d.}{480 \times 1s.\ 6d.}$

= Rs. 21 3as. 10ps. (approx.) = Rs. 21·239583.

9. *Selling rates for gold.*—When the telegraphic transfer rate on London is at or above the upper gold point (see table below), the selling rate, for delivery Bombay, is the same as the buying rate, *viz.*: Rs. 21 3as. 10ps. per tola of fine gold.

When the telegraphic transfer rate on London is below the upper gold point, the selling rate,

(*a*) for delivery London, is:—

Rs. 21 3as. 10ps. + cost of transport, etc.

= Rs. 21 3as. 10ps. + 1·1625 per cent. of Rs. 21 3as. 10ps.

= Rs. 21 7as. 9ps. (approx.) = Rs. 21·484375.

(*b*) for delivery Bombay, is:—

Rs. 21 3as. 10ps. + twice cost of transport, etc.

= Rs. 21 3as. 10ps. + 2·325 per cent. of Rs. 21 3as. 10ps.

= Rs. 21 11as. 9ps. (approx.)

10. *The Gold Points.*—

$$\frac{\text{Reserve Bank selling price (London).}}{\text{Bank of England. buying price.*}} = \frac{21{\cdot}484375 \times 480}{4{\cdot}240909 \times 180} = \left\{ \begin{array}{l} 13{\cdot}50929 \text{ rupees to £1} \\ = 17{\cdot}76555d. \text{ per rupee} \\ (\text{say, } 17\tfrac{49}{64}d.). \end{array} \right.$$

$$\frac{\text{Reserve Bank buying price (Bombay).}}{\text{Cost in Bombay of gold } ex \text{ Bank of England.†}} = \frac{21{\cdot}239583 \times 480}{4{\cdot}297221 \times 180} = \left\{ \begin{array}{l} 13{\cdot}18035 \text{ rupees to £1} \\ = 18{\cdot}20893d. \text{ per rupee} \\ (\text{say, } 18\tfrac{13}{64}d.). \end{array} \right.$$

* Price per fine ounce corresponding to Bank of England buying price of 77*s.* 9*d.* per standard ounce.

† Price per fine ounce corresponding to Bank of England selling price of 77*s.* 10½*d.* per standard ounce, *plus* a percentage to cover transport charges and interest during transit.

SCHEDULE II.

(Paragraphs 102 and 163 of Report).

Business of the Reserve Bank.

Business which the Bank should be authorised to carry on and to transact.

The several kinds of business which the Bank should be authorised to carry on and to transact are specified below :—

(1) It may make and issue bank notes.

(2) It may accept money on deposit on current account from and collect money for the Government of India, Provincial Governments, banks and bankers.

(3)—(*a*) It may buy, sell, or rediscount bills of exchange, promissory notes, or other commercial paper, arising out of *bonâ fide* commercial or trade transactions, bearing two or more good signatures, one of which must be that of a bank or banker, and having a maturity not exceeding 90 days, payable in India.

(*b*) It may buy, sell, or rediscount, to an amount not exceeding 20 per cent. of the bank's total discounts, bills of exchange, promissory notes, or other commercial paper, bearing two or more good signatures one of which must be that of a bank or banker, drawn or issued in respect of current transactions for agricultural purposes, and having a maturity not exceeding six months.

(*c*) It may buy, sell, or rediscount bills of exchange and promissory notes, with a maturity not exceeding 90 days, bearing the endorsement of a bank, issued or drawn for the purpose of carrying or trading in Government of India securities.

(*d*) It may buy and sell securities of the Government of India, or of a Provincial Government or a local authority in India, having not more than six months to run, provided that the amount of such securities held does not, in the aggregate, exceed at any time an amount equal to 25 per cent. of the liabilities of the banking department in respect of deposits.

(4) It may make loans or advances for fixed periods not exceeding 90 days against the security of :—

(*a*) Stocks, funds and securities (other than immoveable property) in which a trustee is authorised to invest trust money by any Act of Parliament or by any Act of the Governor-General in Council.

(*b*) Gold coin and bullion or the documents relating to the shipment or storage thereof.

(*c*) Such notes, drafts, bills of exchange and bankers' acceptances as are eligible for purchase or rediscount by the bank (but advances against securities specified in (3) (*b*) shall not exceed 20 per cent. of the total advances made by the bank).

(*d*) Such foreign drafts and acceptances as are eligible for purchase by the bank and are referred to in clause (6).

(5) It may make advances to the Government of India for Ways and Means purposes, provided that the whole of the advances is repaid not later than at the end of the quarter following the close of the fiscal year in respect of which the advances were made.

(6) It may buy from and sell to banks, bankers, and parties approved by the Central Board of the bank, in amounts of not less than the equivalent of Rs. 1 lakh, transfers by telegram or letter, sight drafts, trade acceptances, bankers' acceptances, and bills of exchange (including treasury bills), drawn

in or on places in such foreign countries as adhere to the gold or gold exchange standard, of a maturity not exceeding 90 days, and it may keep in such foreign countries credit balances with banks or bankers.

(7) (a).—It may invest a sum, not exceeding its paid-up capital and reserve, in securities, having not more than 5 years to run, of the Government of India, or other Governments, provided that the capital and interest of such latter securities are payable in gold or a currency which by statute is convertible into gold.

(b) It may invest its staff and superannuation funds in securities of the Government of India of any maturity.

(8) It may buy and sell all securities which are eligible as, and utilised for, the cover of the note issue, as defined in the clause dealing with the conditions governing the issue of notes by the bank.

(9) It may issue demand drafts and make, issue and circulate bank post bills made payable on its own branches.

(10) It may accept the custody and management of moneys, securities and other articles of value.

(11) It may sell and realise all property, whether moveable or immoveable, which may in any way come into the possession of the bank in satisfaction, or part satisfaction, of any of its claims.

(12) It may act as agent for the Government of India and Provincial Governments in the transaction of the following kinds of business, *viz.* :—

(a) The buying and selling of precious metals.

(b) The buying, selling, transferring and taking charge of any bills of exchange securities or any shares in any public company.

(c) The receiving of the proceeds, whether principal interest or dividends, of any securities or shares.

(d) The remittance of such proceeds, at the risk of the principal, by public or private bills of exchange payable either in India or elsewhere.

(13) It may buy and sell gold whether coined or uncoined.

(14) It may open accounts in foreign countries, and act as agent or correspondent of any bank carrying on business in or outside India.

(15) Generally, it may do all such matters and things as may be incidental or subsidiary to the transacting of the various kinds of business hereinbefore specified.

Business which the Bank should not be authorised to carry on or to transact.

The kinds of business which the Bank should *not* be authorised to carry on or to transact are the following:—

(1) It shall not engage in trade, or otherwise have a direct interest in any commercial, industrial, or other undertaking, save interests which may in any way come into the possession of the bank in satisfaction, or part satisfaction, of any of its claims, provided that these interests are disposed of at the earliest possible moment.

(2) It shall not purchase its own shares, or the shares of any other bank or corporation, or grant loans upon the security of the same.

(3) It shall not advance money on mortgage of fixed property, or on notarial or other bond, or cession thereof, or become the owner of fixed property except so far as is necessary for its own business premises.

(4) It shall not make unsecured loans or advances.

(5) It shall not draw or accept bills payable otherwise than on demand.

(6) It shall not accept money on deposit for a fixed term, or allow interest on credit balances.

SCHEDULE III.

(PARAGRAPH 145 OF REPORT.)

NOTE SHOWING THE EFFECT OF THE COMMISSION'S PROPOSALS ON THE CONSTITUTION AND WORKING OF THE RESERVES.

(For purposes of this Note, gold and sterling have been converted at 1s. 6d. per Rupee.)

1. The following is (in aggregate) the constitution of the present Paper Currency and Gold Standard Reserves as on the 30th April, 1926:—

Liabilities.	*Rs. crores.*	*Assets.*	*Rs. crores.*
Note issue	185	Silver	85
Rupees redemption	*	Rupees securities	57
		Sterling securities	81
		Gold	30
			253

2. Under the scheme outlined in the Report the following changes are contemplated:—

(1) *Liabilities.*—Initial liabilities will include Rs. 50 crores† in respect of the rupee circulation (inclusive of the rupees retained in Reserve). Future liabilities will be increased by the full amount of further note issues. (Paragraph 146 of Report).

(2) *Assets.*—(*a*) Gold and gold securities will be 40 per cent. of liabilities (minimum) from outset.

(*b*) Gold will eventually be 25 per cent. of liabilities (minimum), to be attained by the following stages: not less than 20 per cent. after 5 years, and not less than 25 per cent. after 10 years; with a minimum (overriding) of 30 crores.

(*c*) Rupee securities will be not more than 25 per cent. of liabilities, with a maximum (overriding) of 50 crores.

(*d*) Rupee coin will not be held in excess of the maxima set out below:—

To end of 3rd year	70 crores	or 10 per cent. of liabilities whichever is greater.
From end of 3rd to end of 6th year	50 ,,	
From end of 6th to end of 10th year	35 ,,	
From end of 10th year	25 ,,	

(Paragraph 145 of Report).

3. The following transitory provisions have been recommended:—

(*a*) In order to carry out provisions (*c*) and (*d*) above, and to enable the new Bank to show in the opening accounts of its Issue Department a reserve ratio of gold and gold securities to liabilities of not less than 50 per cent. (*i.e.*, to show a good margin above the minimum require-

* The amount of the Gold Standard Reserve, whose functions include this liability, is Rs. 53½ crores.

† This figure may be subsequently increased or decreased, according as there is a net absorption of rupees or a net return from circulation. (*See* paragraph 3 (*c*) of this Schedule.)

ment), the Government of India should replace 7* crores of their created rupee securities by gold securities. If the Government should find it difficult to do so immediately they may be allowed to replace such rupee securities by 7* crores of Government of India sterling Treasury Bills (created *ad hoc*), these to be replaced within 2 years by gold securities of the kinds laid down elsewhere as eligible to be held in the Reserve, (Paragraph 145 of Report).

(*b*) The surplus of 18* crores in assets at the outset should be retained by Government in the form of silver, including the whole of the silver bullion, the balance being in silver coin. The Government should not re-issue (except to the Bank on demand) this coin or any rupee coin delivered by the Bank subsequently as redundant, *vide* (*c*) below. (Paragraphs 145 and 148 of Reports.)

(*c*) The Bank should have the right to deliver to the Government redundant rupee coin in Reserve, *i.e.*, any rupees coming into the Reserve in excess of the maxima stated in paragraph 2 (*d*) above. The Government would pay for every Rs. 5 thus received in coin Rs. 4 in notes, gold or gold securities, the Bank writing off the difference, of Re. 1, by a reduction of the figure of rupee redemption liability. (Paragraph 147 of Report.)

The reverse procedure would be followed when rupees were delivered by the Government to the Bank on demand.

4. As a result of these proposals the constitution of the Reserve would at the outset* be as follows:—

Liabilities.		*Assets.*		
Note issue	185	Silver coin	67	
Rupee redemption	50	Rupee securities	50	
		Gold securities	88	118= 50%
		Gold	30	
	235		235	

Gold and sterling securities would thus be 50 per cent. of total liabilities; and the Bank would be enabled, without overstepping the minimum statutory reserve ratio, to issue further notes against bills to the maximum of 60 crores.

* These figures, and those in the table in paragraph 4, are based upon the composition of the Reserves as in paragraph 1 above. They will require modification if the composition is different at the time of transfer.

SCHEDULE IV.

(PARAGRAPH 157 OF REPORT.)

SUGGESTED FORM FOR PRESENTATION OF THE RESERVE BANK'S ACCOUNTS.

RESERVE BANK OF INDIA.

An Account pursuant to the Reserve Bank of India Charter Act, 192 , for the week ending on the day of .

ISSUE DEPARTMENT.

Liabilities.			*Assets.*	
Bank Notes held in the Banking Department	Rs.		Rupee coin . . .	Rs.
Bank Notes in circulation	Rs.		Government of India rupee securities .	Rs.
Total Bank Notes issued .		Rs.	Domestic Bill of Exchange . . .	Rs.
Government of India Notes in circulation		Rs.	Gold securities . .	Rs.
Rupee redemption . .		Rs.	Gold specie or bullion .	Rs.

Ratio of gold and gold securities to liabilities, per cent.

Dated the day of , 19 .

Chief Cashier.

BANKING DEPARTMENT.

Liabilities.	Rs.	*Assets.*	Rs.
Capital paid up . .		Notes . . .	
Reserve .		Silver rupee coin .	
Deposits—		Subsidiary coin . .	
(*a*) Government		Bills discounted—	
(*b*) Bankers		(*a*) Domestic . .	
(*c*) Others		(*b*) Foreign . .	
Bills payable		(*c*) Government of India Treasury Bills . .	
Other liabilities		Balances held abroad .	
		Loans and advances to the Government .	
		Other loans and Advances . .	
		Investments . .	
		Other Assets . .	

Dated the day of , 19 .

Chief Cashier.

SCHEDULE V.

(PARAGRAPH 166 OF REPORT.)

SUGGESTED OUTLINE FORM OF THE STATUTORY PROVISIONS TO BE IN FORCE DURING THE PERIOD OF TRANSITION.

1. The Government of India shall receive from any person making a demand at the Office of the Controller of the Currency, or the Deputy Controller of the Currency, Bombay, or at any other office of the Government which may be notified for the purpose in the Gazette of India, gold in the form of bars containing approximately 400 fine ozs., in exchange for legal tender money, at the rate of Rs. 21 as. 3 ps. 10 per tola of fine gold, subject to conditions to be notified in the Gazette of India.

2. The Government of India shall sell to any person in India who makes a demand in that behalf at the Office of the Controller of the Currency, Calcutta, or the Deputy Controller of the Currency, Bombay, or at any other office of the Government which may be notified for the purpose in the Gazette of India, and pays the purchase price in any legal tender money, gold for delivery at Bombay at the rate of Rs. 21 as. 3 ps. 10 per tola of fine gold or at the option of the Government an equivalent amount of gold exchange (as defined below) payable in a country or countries outside India maintaining a free gold market and approved by the Governor General in Council subject to the condition that no single demand for gold or gold exchange shall represent a less value in gold than approximately 400 fine ozs.

The "equivalent amount of gold exchange" referred to shall be a sum in foreign currency calculated by the Government of India to represent the standard price of one tola of fine gold in the country outside India concerned less an amount representing the normal charges of a remittance of gold bullion from India to the country concerned. For this purpose the Government shall notify in the Gazette of India the country or countries upon any one of which, at the choice of the purchaser, gold exchange will be issued; and the rates of gold exchange.

Note.—The provision as drafted above is intended to relate to the period during which the Government of India remains the currency authority. From the date when the control of the currency is transferred to the Reserve Bank to the date when the Bank assumes the final obligation to buy and sell gold, a statutory provision imposing similar obligations on the Bank should be put into force, with the requisite modifications. There should then be a proviso that the notifications as to the conditions of purchase of gold, as to the rates of gold exchange, and as to the country or countries upon which gold exchange will be issued, should be subject to the previous approval of the Governor-General in Council.

NOTE BY SIR NORCOT WARREN.

Whilst joining in the recommendations of this Report, and advocating them without reservation, I wish to avoid any possibility of misconception by expressly stating that I do so in my personal capacity as a member of the Commission, and not in any representative capacity on behalf of the Imperial Bank of India. As a member of the Commission, my duty, which is wholly towards the public, is separate and distinct from my duty towards the Institution of which I am a Managing Governor. It will therefore be understood that by making these recommendations in so far as they may affect the Imperial Bank of India, I have neither the desire nor the capacity to commit that Bank.

NORCOT WARREN.

MINUTE OF DISSENT BY SIR PURSHOTAMDAS THAKURDAS.

I have signed the Report subject to the following Minute of Dissent.

I.—HISTORICAL RETROSPECT.

1. My colleagues state in paragraph 11 of the Report that the stability of the gold value of the rupee is " based upon nothing more substantial than a policy of the Government, and at present that policy can be found defined in no notification or undertaking by the Government. It has to be implied from the acts of the Government in relation to the currency, and those acts are subject to no statutory regulation or control."

2. With this I entirely agree. But it is necessary to enquire whether the currency system and practice as developed, constitute a material departure from the main principles of the policy laid down 27 years ago, accepted by Government, and still binding on them, and if so, whether such departure was made either with the consent of representatives of the people, or with the approval of the Government of India, who were best able to judge of India's requirements.

3. The present currency system in India, as referred to us, starts with the closing of the Indian mints to free coinage of silver in 1893, and the recommendations of the Fowler Committee to link the rupee to gold, making the former a token coin for internal circulation. There have been one Royal Commission and one Committee since the Fowler Committee reported, and both give a history of the currency system of India since 1898. Whilst anxious, therefore, not to duplicate the historical facts by repeating them here, I feel it incumbent upon me, for a full elucidation of the problem before us, to summarise the history of the Indian currency system since 1898, by quoting the relevant despatches between the Government of India and the Secretary of State for India, with reference to each important aspect of the working of the Fowler recommendations, and the official policy supposed to have been based thereon.

4. Till 1893, India had a silver standard with free coinage of silver, and the rupee was a full value silver coin. Owing to the discarding of silver as a standard of value in leading countries in the West after the Franco-German War, wild fluctuations took place in the rates of exchange between India and gold standard countries. In response to a widespread general feeling amongst the organised sections of the commercial community in India, the Government of India proposed to the Secretary of State the stopping of the free coinage of silver with a view to the introduction of a gold standard. The Herschell Committee, to whom the proposal was referred for investigation and report, approved of the Government of India's proposals, with certain modifications. The recommendations of that Committee were accepted* by Her Majesty's Government; and in 1898 the Fowler Committee was appointed to consider and report on " the proposals of the Government of India for making effective the policy adopted by Her Majesty's Government in 1893 and initiated in June of that year by the closing of the Indian Mints to what

* *Note.*—See Notifications of 26th June, 1893, whereby arrangements were made for:—

(1) The receipt of gold at the rate of 7·53344 grains of fine gold per rupee.
(2) The acceptance of sovereigns at Rs. 15.
(3) The issue of currency notes in exchange for sovereigns or gold bullion.
(See pp. 66, 67, East India—Mint for Gold Coinage, 1913, No. 495.)

is known as the free coinage of silver. That policy had for its declared object the establishment of a gold standard in India."*

The Fowler Recommendations.

5. The Fowler Committee "looking forward . . . to the effective establishment in India of a gold standard and currency based on the principles of the free inflow and outflow of gold,"† recommended that:—

(1) The Indian Mints should continue closed to the unrestricted coinage of silver and should be opened to the unrestricted coinage of gold.

(2) The sovereign should be made legal tender and a current coin.

(3) The ratio between the rupee and the pound sterling should be Rs. 15 to the pound, *i.e.*, the exchange value of the rupee should be 1*s*. 4*d*.

(4) No legal obligation to give gold for rupees for merely internal purposes should be accepted; but

(5) The profit on the coinage of rupees should be held in gold as a special reserve and made freely available for foreign remittances whenever exchange fell below gold specie point.

(6) The Government should continue to give rupees for gold, but fresh rupees should not be coined until the proportion of gold in the currency was found to exceed the requirements of the public.

These recommendations were accepted "without qualification" by the Secretary of State, who on the 25th of July, 1899, "requested the Government of India to make reparation for the coinage of gold."‡

(i) Gold Currency.

First Stage: 1899 to 1902.

6. On the 31st of July 1899 the Viceroy telegraphed to the Secretary of State that the Government of India were preparing for the coinage of gold. The subsequent history of this essential project of a gold mint is recorded by the Government of India in their Despatch No. 110, of the 16th of May 1912:—

"(5) The Government of India put forward definite proposals for establishing in the Bombay Mint a branch of the Royal Mint for the coinage of sovereigns. A proclamation to effect this object was drafted, and received the approval of the Lords Commissioners of the Treasury. Meanwhile, difficulties had arisen regarding a number of administrative details connected with the establishment of the proposed branch mint. These difficulties occasioned much correspondence between the Secretary of State, the Treasury, and the Government of India, and the latter expressed their willingness throughout to carry out the requirements of the authorities of the Royal Mint. In May 1901 the Mint authorities expressed themselves as satisfied, but the Lords Commissioners of the Treasury, for the reasons given in their letters, No. 8239, dated the 22nd of May 1901 and No. 10,489, dated the 9th of July 1901, copies of which were forwarded with Lord George Hamilton's Despatch, No. 130, dated the 26th of July 1901, invited the Secretary of State to reconsider the whole question. They admitted that the original decision to coin sovereigns in India was a wise one, as indicative of the determination of the Government of India to adhere to a gold standard and of their intention to take practical measures to establish it. They pointed out, however, that subsequent experience had shown that the gold standard was already firmly

* Fowler Committee Report, Par. 1.

† Fowler Committee Report, Par. 54.

‡ Pars. 6 and 7, p. 8, East India—Mint for Gold Coinage, 1913, No. 495.

established in the public confidence, that sovereigns were being readily attracted to India whenever required, and that there was no reason for believing that the position of the gold standard in India would be strengthened, or public confidence in the intentions of the Government of India confirmed, by the mere provision of machinery for the manufacture of gold coins in the country. They further pointed out the practical difficulties in the way of the establishment of a branch of the Royal Mint in India, an arrangement which they described as anomalous, and likely in practice to give rise to inconvenience and possible friction.

"(6) Upon receipt of the views of the Lords Commissioners, the Government of India decided, for the time being, not to persevere with the proposals. In their despatch of the 25th of December 1902 they refrained from expressing any agreement or disagreement with the reasons advanced by the Treasury. But they had ascertained that the chief Indian Mining Companies had made arrangements for the regular sale of their gold outside the country, and that they were unlikely to alter those arrangements at an early date. In the absence of an assurance that a steady supply of Indian gold would be available for minting, Lord Curzon's Government preferred to drop the scheme, at the same time expressing their willingness to revive it should conditions change.

"(7) No public explanation was given in India of this sudden recession from what had hitherto been regarded as an essential feature of the currency policy inaugurated in 1893 and definitely established on the recommendations of the Currency Committee of 1898 . . . ."

7. It is necessary to note here that this decision followed the failure of the Government's attempt to issue sovereigns in 1900 owing to famine conditions,* when, because of the low purchasing power then prevailing throughout India, the sovereign was an unsuitable form of currency.

Second Stage: 1909-1910.

8. In 1909, the Government of India in their despatch No. 236 of the 30th of September 1909 applied to the Secretary of State for a holding of about £9 million liquid gold in the Paper Currency Reserve, in order to make a gold currency possible. They stated in Paragraph 8 of that despatch that the popularity of the sovereign was rapidly increasing till checked by the crisis of 1907-8, and that sovereigns were actually changing "hands at a premium even in the chief commercial centres of the country, while for ordinary purposes they are practically unobtainable." They also urged in the same despatch: "We are of opinion that you should stay further drawings other than those required for ways and means purposes, for if further trade demand for money be genuine, the result must then be that gold will come out to us in India." (Paragraph 10.)

9. The Secretary of State by his despatch No. 25 of the 18th February, 1910, Paragraph 4, rejected these suggestions of the Government of India on the ground that they "might cause the periodical recurrence of stringency in the London money market." He also refused, by Paragraph 6 of his despatch, to allow the Government of India to publish the correspondence with him on the subject.

Third Stage: 1912-1913.

10. In 1912, the Government of India again urged the opening of a branch of the Royal Mint in India by their despatch No. 110 of the 16th of May 1912. This despatch gives a full history of the gold mint question from 1899 to 1912, and meets the various arguments that are advanced against a gold currency in India. The Secretary of State forthwith got in touch

* Chamberlain Commission Report, Par. 25, p. 10.

with the Treasury on the 27th of June 1912, and the latter by their reply of the 8th of August 1912, intimated that the Lords Commissioners of His Majesty's Treasury "are prepared to co-operate in giving effect to the proposal" but regret that they are "quite unable to agree to any scheme involving divided control." The Secretary of State, by his despatch No. 139 of the 18th of October 1912 communicated the Treasury's reply to the Government of India, pointing out in Paragraph 3 the two alternatives offered by them. In Paragraph 5 of his despatch he intimated to the Government of India that if both the alternatives "are dismissed, it will remain to consider whether it is desirable to produce at one of the Indian Mints a separate Indian gold coin of the denomination of, say, Rs. 10; this course would be inexpensive and would avoid the interference of the British authorities in your general coinage operations." He added that he would be prepared "to sanction the issue of such a coin."

11. On the 20th of January 1913, the Government of India in a telegram said: "As you anticipated, we do not favour either of the alternatives offered by the Treasury. We therefore accept your offer to sanction the issue of a separate India gold coin of the denomination of Rs. 10. We shall submit our proposals as to details of the coinage in due course." Thereafter it appears from Sir Lionel Abrahams' evidence before the Chamberlain Commission (Q. 1143) that discussion took place as to the dates on which "it would be desirable to make an announcement." On the 24th January, however, the Secretary of State suggested that, "before any final decision was taken, the usual procedure for eliciting public opinion in India should be followed." It need only be recalled here that in their despatch of the 16th of May 1912 the Government of India had stated that "it was not until last year, when a resolution was moved in the Imperial Legislative Council by Sir Vithaldas Thackersey, that the Government of India were formally invited to revive the proposals which had so nearly reached fruition a decade previously, and to embark on the coinage of gold. The discussion thus started has been vigorously taken up by the Press and by commercial interests both in India and England, and the whole subject has been thoroughly ventilated in a manner which makes any special reference to mercantile bodies in this country unnecessary." The Secretary of State informed the Government of India on the 14th of February that the Royal Commission, by that time proposed, "would inquire *inter alia* into the Indian currency administration." On the 10th of April the Government of India wrote that "the only possible course now" was to leave the question of the gold coinage for the Commission to decide.

Fourth Stage: Wartime Coinage.

12. During the War, the Bombay Mint was made a branch of the Royal Mint for the coinage of sovereigns for a short period. Later on, when some technical difficulties arose in this connection, the Bombay Mint coined gold mohurs of the weight and fineness of the sovereign. The Babington-Smith Committee, in Paragraph 66 and 67 of their Report, recommended "that the branch of the Royal Mint which was opened in Bombay during the war for the coinage of sovereigns and half-sovereigns and has since been temporarily closed, should be reopened, and that arrangements similar to those in force in the United Kingdom should be made for the receipt of gold bullion from the public for coinage. The Government of India should announce its readiness to receive gold bullion from the public, whether refined or not, and to issue gold coin in exchange at the rate of one sovereign for 113·0016 grains of fine gold, subject to a small coinage charge."

Fifth Stage: Post-war Guarantee.

13 On the 24th of January 1922, Sir Malcolm Hailey, then Finance Member, spoke as follows in the Legislative Assembly, on a resolution moved

by the late Sir Vithaldas D. Thackersey on the subject of Currency and Exchange:—

"Now Sir, let me turn to the second part of the Resolution. It proposes that the suggested Committee should consider the question of opening the Indian Mints to the free coinage of gold. Now, I must really assume that my Honourable friend, Sir Vithaldas Thackersey, expert as he is in these questions, has really included this in his Resolutions to satisfy the feelings of some of his friends, rather than because he himself supposes that this question does actually need the further investigation of an expert Committee. He is well aware, Sir, that it was a cardinal feature in the policy of the Babington-Smith Committee that the Indian Mints should be opened to the free coinage of gold. Indeed, one of the intentions of the Committee in fixing the rupee on a gold basis was to permit of the free use of gold currency in India, and the opening of the Mints to the free coinage of gold is an aid to such a process, though of course it is not in itself an essential condition of it. We, Sir, are prepared out here to coin gold as soon as the need for gold currency arises. Sir Vithaldas Thackersey suggested that the Royal Mint might on technical grounds refuse to allow us to do so. He need have no fear on that score. I can give him a guarantee that, as soon as the demand for gold currency arises, the Mint will be ready for it."*

14. This, in short, is the history of what the Treasury called in their letter dated the 9th of July 1901 to the India Office, "the frank abandonment of one of the details of the policy recommended by the Indian Currency (Fowler) Committee, which experience has shown to be unnecessary." In their preceding letter of the 22nd of May, to the India Office, they had already expressed the opinion that "The gold standard is now firmly established, and the public requires no proof of the intention of the Indian Government not to go back on their policy, which is beyond controversy."

(ii) Gold Standard Reserve.

15. Another important recommendation, material to the Fowler Committee's scheme adopted by the Government of India, was that "any profit on the coinage of rupees should not be credited to the revenue or held as a portion of the ordinary balance of the Government of India, but should be kept in gold as a special reserve, entirely apart from the Paper Currency Reserve and the ordinary Treasury balances."*

The First Departure.

16. In September 1900, the Government of India proposed to inaugurate this special reserve of gold. But the profits on coinage for the preceding year, amounting to £1 million, were temporarily unavailable, having been used to meet pressing famine demands. The then Viceroy, Lord Curzon, and the Finance Member, Sir Edward Law, disagreed on the policy to be adopted with regard to the gold holding in the Paper Currency Reserve. A lengthy despatch, No. 302 of the 6th September 1900, was addressed to the Secretary of State, with, in all, four Minutes upon it, one from the Viceroy and three from the Finance Member. As one of his reasons for differing from the Finance Member, the Viceroy wrote: "I have a natural suspicion of anything that may tend, in the present early stage of our currency policy, to cause alarm. Most things that the Government of India do in the region

* See Legislative Assembly Debates, Vol. II, No. 21, 24th January, 1922, pp. 1842-1869.

† Par. 60, Fowler Committee Report.

of finance are misrepresented; many are misunderstood. We are constantly accused of having no confidence in our policy and of not pursuing it with consistency. I think that we should be very careful about taking any steps that may seem to give ground for these charges."*

17. The Finance Member in Paragraph 26 of his first Minute said: "I do not lose sight of the fact that, however readily saleable our gold investments, they are not quite the same thing as actual gold, but holding such a sum as I contemplate in the actual metal, there would, under all conceivable circumstances, be plenty of time to effect gradual sales of the securities for the replenishment of the stock of gold, should the necessity arise."

18. In his final Minute, dated the 23rd of August 1900, the Finance Member recorded the fact that "the general question of the advisability of legislation affecting our exchange policy was discussed in Council, and the view was, I think, unanimously accepted that such legislation should, if possible, be avoided."

19. The Secretary of State, replying by his despatch No. 232 of the 13th of December 1900, said in paragraph 3, that he was fully convinced of the advantages of maintaining a special gold reserve, and that, "in order to mark the primary object of its formation, ... the title to be assigned to it should be the Gold Standard Reserve," In paragraph 4 of his despatch he parenthetically observed that the word "gold" used in Paragraph 60 of the Fowler Committee Report appeared to be interpreted by Sir Edward Law as including "securities saleable for gold," and in Paragraph 5 he gave his decision: "This proposal is in harmony with the 60th paragraph of the Report of the Indian Currency Committee, and I fully concur in the principle which it enunciates."

20. Paragraphs 6 and 7 of the despatch lay the foundation of the departure from the Fowler Committee Report and need to be quoted in full here.

"(6) In order to ensure the due application of the gain made through the coinage, it is advisable that your Government should once in three months make up an account of the receipts and charges, and should forthwith remit the net profit to be held by the Secretary of State in this country.

"(7) It does not appear necessary to specify precisely in what gold securities the reserve shall be invested, whether in Consols or India Stock, or in any other manner. This will be at the discretion of the Secretary of State in Council from time to time, and the result will be periodically reported to the Government of India, and published in its Gazette."

21. Thus, while the question in dispute referred to the Secretary of State actually concerned the Paper Currency Reserve, he gave a decision regarding the Gold Standard Reserve, and the interpretation put on the word "gold" in Paragraph 60 of the Fowler Committee's Report was 13 years later a subject of close examination of the India Office representative before the Chamberlain Commission.

22. On the 7th of December 1906, the Secretary of State telegraphed to the Viceroy, with reference to the latter's information about extreme stringency and the possibility of serious panic in India, that "for various reasons I wish to avoid addition of gold to Currency Reserve in London. This would, for example, entail diminution of reserve of Bank of England and, by its effect on discount rates in London, would probably interfere with arrangements for renewing debentures of Guaranteed Railways maturing in December."

* Par. 4, Viceroy's Minute.

Diversion for Railway Purposes.

23. In July 1907, the Secretary of State decided that £1 million out of the profits on coinage might safely be diverted from the Reserve to be utilised on railway capital expenditure, as recommended by a Departmental Committee on Indian railways. The Government of India, in their despatch No. 296 of the 8th of August 1907, Paragraph 3, observed as follows:—

"From the report of your announcement in Parliament, we understand that on the advice of the Committee which was recently appointed to consider the question of railway finance, you have decided on a different course. We do not therefore propose to trouble you with the reasons which led us to the conclusions outlined above. We accept your decision, although some of us entertain doubts as to its expediency, and although we should all have preferred if it had been possible to give the commercial community in India an opportunity of stating their opinion regarding the diversion of coinage before final orders were issued."

Employment in temporary Loans.

24. In 1908, the Secretary of State by his telegram of the 2nd of April, intimated to the Government of India that the balance of the Gold Standard Reserve would be "lent on security on short temporary loans."

The Government of India's protests.

25. In April 1909, the Government of India renewed their appeal to the Secretary of State that the whole of the profits on coinage should be devoted to the Gold Standard Reserve and should be held in liquid gold. In their despatch No. 89 of the 1st of April 1909 they emphatically pointed out that any failure to fulfil the "definite pledge of our active support of the Gold Standard, ... either through the exhaustion of the reserve or for other cause, would shake the public confidence in our Currency policy to a degree which it would be difficult to estimate." (Paragraph 2.)

26. In Paragraph 3, they said that the "Gold Standard Reserve . . . is the recognised fulcrum of our whole currency system; and its strength is of vital importance both to Government and to the merchants, capitalists and investors who are associated with us in the development of India."

27. In Paragraph 4, they expressed doubt whether the "Gold Standard Reserve has ever yet approached the position which it ought to occupy." They further drew attention to the fact that, between November 1907 and January 1909, they lost £15 million of gold, and pointed out that "this is the result of a little more than a single year of adverse conditions and of a famine which was more restricted in its area than is frequently the case with similar calamities." With these preliminary observations, they submitted their first definite proposal for the Secretary of State's consideration.

28. With regard to the Secretary of State's decision to divert £1 million from the Gold Standard Reserve to railway capital expenditure, in Paragraph 5 they said:—

"We deprecated the decision at the time, but accepted it and have defended it against an outburst of public criticism in India. You subsequently determined that half the profits on the coinage of rupees should be consistently diverted in the same manner, and this course has accordingly been followed so long as any profits accrued. We would now ask you, however, to reconsider your decision, and to allow the future profits on coinage to pass into the Gold Standard Reserve without deduction, until the Reserve stands at a much higher figure than it has yet attained. We do not yield to your Lordship in our desire to press forward railway development in India; but we are convinced that the stability of our currency is a far more vital factor in the welfare of the country than the pace at which our railway facilities are extended. It is highly significant that this view is so widely shared by the mercantile community, in spite of the strong personal interest which attaches large sections of them to an active railway policy. We have already forwarded to you the expression of opinion by the Bombay Chamber of Commerce on the subject; and we now submit, for your information, copies of similar protests which we received from the Chambers at Calcutta, Madras, and Karachi. The position has again been dealt with, in a similar strain and with much conviction, by the Chairman of the Bombay Chamber, whose remarks on the subject at the Chamber's annual meeting on the 3rd instant have met with the general approval of the business public in India. We find ourselves in entire accord with these views, and we would earnestly press upon your Lordship the impolicy of retarding the growth of the Reserve when circumstances again permit us to renew the coinage of rupees."

29. In Paragraph 6 they submitted another aspect of the Gold Standard Reserve, in the following words:—

"Another aspect of the Gold Standard Reserve which attracts much criticism in India is the form in which it is held. When the Reserve was first established, it was the desire of Lord Curzon's Government that it should be kept in liquid gold in India. Your predecessor decided to the contrary, and it was invested in gold securities, which have lost appreciably in value. We are not prepared to revive the proposal that the gold should be held in India, though it is our duty to refer to the very strong feeling in favour of such a course which prevails in this country."

30. In Paragraph 7 they pressed for holding a substantial part of the Reserve in liquid gold, and the whole of this and the following Paragraph can usefully be quoted here:

"But, while we do not press for any change in the location of the Gold Standard Reserve, we attach very great importance to our second proposal, that a substantial part of the Reserve should be held in a liquid form. This seems to us to be necessitated both by expediency and on broader grounds of policy. We do not lay stress on the loss that has occurred in selling the Reserve securities during 1908; those losses have been more than covered by the accrued interest. What we fear is a combination of events which would demand the employment of the Reserve at a time when large sales of British Government securities in London would be contrary to Imperial interest. Such a combination is by no means inconceivable; and even in less serious situations the free employment of the Reserve might be gravely hampered by the form in which it is now held. The point is one on which informed public opinion in India is singularly unanimous. We are frequently asked why we strain after interest on the Reserve which is the basis of our currency system, and consequently one of the chief pillars of the credit of India; and it is pointed out that other countries are careful to retain the ultimate foundation of their credit in bullion. We think these views deserve every consideration, and we are satisfied that it would have an excellent effect if your Lordship decides to refrain from further investment of the Reserve gold. That such a course is right on general grounds we consider to be beyond question. Our strength in combating a low exchange depends, broadly speaking, on our ability to reduce the supply of rupees and to augment the supply of gold. If we can do both simultaneously, our intervention is the sooner effective. At present, we can only reduce the supply of rupees; for our gold has already been put on the market; and all that is meant by realising it is the transfer of certain securities from Government to another holder. Moreover, we conceive that the position of the Government of India in the markets of the world would be much stronger as the possessor of a large store of liquid gold than as the possessor of a corresponding capital in Consols or similar securities.

In the former case, the Indian Government might in emergency be powerful to help the market; in the latter there would always be the potential danger of their wishing to realise at an inconvenient season. We would therefore urge on your Lordship the propriety of building up a substantial share of the Reserve in liquid gold, to be held under as nearly as possible the same conditions as the currency gold in London.

"We have intentionally avoided any general review of our currency policy. Our object for the moment is to place before you the views which are held in India regarding the Gold Standard Reserve, and the convictions that have been forced upon us by the experience of the last year. The two modifications in procedure which we recommend are in entire harmony with the declared policy of supporting the Gold Standard, and they will go far to secure public confidence in our intentions."

The Secretary of State's Reply.

31. The Secretary of State in his despatch of the 2nd of July 1909 admitted the importance of the subject of the Government of India's despatch of the 1st of April. But he refused to accede to the Government of India's request, "in view of the pecuniary disadvantage of holding a part of the Gold Standard Reserve in gold," and he accepted "the responsibility" for realising gold securities instead of gold "on occasion arising."

32. In Paragraph 10 of his despatch, he said as follows:—

"The consideration dealt with in the preceding paragraph is the most important of those mentioned by you in favour of your proposal, but there are certain others which should be noticed.

"One is that it is the desire of Lord Curzon's Government that the Reserve 'should be held in liquid gold in India' and that Lord George Hamilton overruled their recommendation to this effect, and decided to hold the Reserve in securities. I find, on referring to the correspondence which took place when the Reserve was established, that Lord George Hamilton understood the Government of India to desire that the Reserve should be held either in gold or in securities saleable for gold, or partly in one form and partly in the other. Whether his understanding of their wishes was correct or not, it is clear that it would not now be reasonable to attach more importance to suggestions regarding the management of the Reserve which were made before its establishment than to the results of the experience, extending over more than eight years, which has since been gained.

"A second argument, to which you refer with approval, is that 'other countries are careful to retain the ultimate foundation of their credit in bullion.' I understand that these words are meant to convey that Governments which issue notes encashable in gold or silver on demand are in the habit of holding gold or silver in order to provide for the encashment. This remark is accurate, except so far as it needs to be qualified by a reference to the large fiduciary issues of most Governments; but it has little, if any, bearing on the question of the most suitable form for the Gold Standard Reserve. That Reserve will presumably be used in future, so far as it is used at all, for defraying the Home Charges when Council bills cannot be sold at or above the gold point, or for meeting London bills drawn by the Government of India. For either purpose easily realisable securities or bank balances are as useful as gold, and there is therefore no advantage in holding the latter.

"A third argument used by you is that it is desirable that the Government of India, when combating a low exchange, shall be in a position not only to contract the circulation of rupees in India, which is done under the existing system, but also to expand the circulation of gold elsewhere simultaneously (the object of the expansion of the circulation of gold being presumably to stimulate trade throughout the world and thus to increase the demand for Indian produce), and that the latter operation is not within your power unless the Gold Standard Reserve is held in gold. I am not disposed to think that the release of such gold as might be held in the Gold Standard Reserve would have an important or speedy effect in creating a favourable balance of Indian trade; but, if it is to be held that this result would follow, it must equally be held that the previous accumulation of gold in the Gold Standard Reserve would, so long as it was proceeding, have an unfavourable effect on the Indian trade balance; and it would certainly injure India's power of borrowing in the London market."

Renewed Protests.

33. In Paragraph 11 he pointed out that in eight years there had been a net gain to the Gold Standard Reserve, after deducting the loss through the sale of securities, of £1,371,063.

34. In September, 1909, the Government of India, by their despatch No. 236, of the 30th of September, made a rejoinder to the Secretary of State's despatch. In Paragraph 4 they expressed their regret at the Secretary of State's decision in the following words:—

"On the second point your Lordship has not seen your way to accept our proposals. Holding that, for the purpose of maintaining exchange, securities capable of easy realisation are as efficient as liquid gold; while they are at the same time producing interest to the credit of the Gold Standard Reserve, you have declined to do more than keep a sum of £1,000,000 of this Reserve uninvested, such amount being either lent from time to time for short periods, on approved security, to approved institutions and firms, or deposited at interest with banks of high standing. We accept this decision with regret. While we admit the force of your argument in normal circumstances, and recognise that existing arrangements adequately met the requirements of the late crisis, we would once more emphasise our conviction that it is necessary to provide, and to assure the public that we do provide, against a situation in which the securities of the Gold Standard Reserve would not be easily realisable, or realisable only at heavy loss." They added, "accepting, however, as we must, your decisions," they desire to discuss the methods to be adopted in meeting exchange difficulties. They suggested a holding of gold in the Paper Currency Reserve in India, and the limitation of Council Drafts so as to build up the gold resources of the country, as already mentioned in Paragraph 8 above.

Diversion of Gold from India.

35. The Secretary of State rejected this request of the Government of India, and, not content with such rejection, he observed in Paragraph 3 of his despatch, No. 25 of the 18th of February, 1910, as follows:—

"As the stock of gold held by you now exceeds £5,000,000 I propose to revive shortly the arrangements which were in force in 1905, 1906, and 1907 for the purchase of gold in transit to England."

In those years, gold destined for India was bought in transit by the Secretary of State from the Exchange Banks, and diverted to England by Council Drafts which carried special rates thus to attract gold (*see* Qs. 910-940, Chamberlain Commission).

36. This is the history of the Executive action taken to carry out the policy recommended in Paragraph 60 of the Fowler Committee Report regarding "gold" reserves, which was accepted by Her Majesty's Government and the Government of India.

(iii) FREE INFLOW AND OUTFLOW OF GOLD.

37. In Paragraph 54 the Fowler Committee said that they looked forward "to the effective establishment in India of a gold standard and currency based on the principles of the free inflow and outflow of gold."

38. In Paragraph 8 of his despatch, No. 140 of the 25th of July, 1899, the Secretary of State communicated to the Government of India as follows:—

"I am also in accord with the Committee as to the general principles by which your Government should be guided in the management of your gold reserve in the absence of a legal obligation to give gold in exchange for rupees, namely, that you should make it freely available for foreign remittances whenever exchange falls below specie point, under such conditions as the circumstances of the time may render desirable."

39. On the 20th of November, 1907, when the American crisis led to a sudden demand for remittance of gold to London, the Viceroy applied to the Secretary of State for authority to refuse gold for export to the Exchange Banks, since such gold could at that time only be drawn from the currency gold in London. By his telegram of the same date the Secretary of State gave the Government of India authority to inform the Exchange Banks of their inability to accede to their application. This authority was not exercised; but, on the first demand for gold for foreign remittances, the "free outflow of gold," recommended by the Fowler Committee, was severely restricted.

(iv) COINAGE OF RUPEES.

40. Regarding the coinage of rupees, the Fowler Committee had recommended that "Government should continue to give rupees for gold, but fresh rupees should not be coined until the proportion of gold in the currency is found to exceed the requirements of the public." (Paragraph 60.) The unfortunate coincidence of a severe famine with the commencement of the introduction of the Fowler Committee's recommendation necessitated coinage of rupees until the time when the after-effects of the famine had passed. But when, in 1909, the Government of India reported that sovereigns were in demand and at a premium,* the refusal of the Secretary of State to permit a substantial holding of gold in India, in order to make a gold currency possible, marked a deliberate departure from the Government's policy as laid down in 1899. Lord Farrer and Lord Welby, in their supplementary minute to the Herschell Committee Report, Paragraph 15, emphasise the importance of this part of their recommendation (subsequently accepted also by the Fowler Committee) in a remarkable manner:—

"Under these circumstances, we could not join in the recommendation contained in the Report, without at the same time recommending that the Government of India should, in view of the ultimate adoption of the whole of their plan, be prepared to secure the convertibility of their token silver currency, and should, with that object, accumulate a sufficient reserve of gold."

(v) POSITION IN 1913.

41. When, therefore, the Chamberlain Commission was appointed by Royal Warrant dated the 17th of April, 1913, the position was as follows.—The Government of India were committed by Statute to a gold standard, and by the acceptance of the Fowler Committee's recommendations (Paragraph 54), to a gold currency, based on the principles of the free inflow and outflow of gold. The main departures from the important principles of the scheme were made under orders of the

* *Vide* Par. 8 above.

Secretary of State, against the repeatedly expressed, and, indeed, tenaciously followed-up protests of the Government of India, who had the backing of the commercial community in India in that period. So apprehensive were the Government of India and the Secretary of State of the effect of these departures from their accepted currency policy, that not less than three times did they enjoin secrecy with regard to their decisions and to breaches of the officially accepted policy.

The following are instances:—

(1) The decision of 1900 to invest the Gold Standard Reserve in securities. (*Vide* Paragraph 18 above.)

(2) The correspondence of 1908-9 regarding the gold reserves, the gold currency and the limitation of sales of Council Drafts. (*Vide* Paragraph 9 above.)

(3) The decision of 1902 to abandon a gold mint. (*Vide* Paragraph 6, "(7)" above.)

(vi) Subsequent Enquiries.

42. At this stage the Chamberlain Commission was appointed. The terms of reference to that Commission include, "the measures taken by the Indian Government and the Secretary of State for India in Council to maintain the exchange value of the rupee in pursuance of or supplementary to the recommendations of the Indian Currency Committee of 1898."

43. The Commission submitted their Report towards the end of February, 1914; but, owing to the outrbeak of war less than six months later, it could not be considered either by the Legislature or by the public of India.

44. On the 30th of May, 1919, the Secretary of State ordered a further enquiry and appointed the Babington-Smith Committee, who were directed in their terms of reference to make recommendations "ensuring a stable gold exchange standard." This change from a gold standard to a gold exchange standard was in absolute contravention of the currency policy officially adopted in 1899, binding on the Government and the country, and still existing as the recognised monetary system of India. It is unnecessary to notice here the recommendations of that Committee.

The Position To-day.

45. The position therefore to-day, as I view it, is that the Government and people of India stand committed to the principles recommended by the Fowler Committee and adopted by the Secretary of State and the Government of India.

(vii) The result of Departures from the Accepted Policy of 1899.

46. The reason why I consider it necessary to give a fuller narrative of Indian Currency history between 1899 and 1913 than my colleagues have done in the Report is, that the correspondence between the Government of India and the Secretary of State for India conclusively shows that the developments in the currency policy of India since 1899 were not justified by the wishes of the Government of India or by the requirements of the people as expressed by that Government. These could all have been met by action in accordance with the policy approved by the Secretary of State and the Government of India. I think it my duty to state the facts bearing on this aspect as they appear in the official correspondence, and I believe that such a presentation of the history of the Indian currency system is material to the recommendations made in the Report, and necessary for a due appreciation of the reasons of my dissent.

47. Many of the recommendations accepted by the Secretary of State and the Government of India in 1899 were departed from by Executive action. It may be asked whether these departures were detrimental to the interests of India. Apart from monetary profit or loss, the development of a currency system different from the one indicated by the Government's acceptance of a policy is undesirable in itself. When such a development is effected without the knowledge of the people most concerned, it becomes a real danger. I do not wish to criticise this aspect further, but will now mention the material loss which India has suffered by these departures:—

(a) It has involved the circulation of a very large number of token coins in India which could not be converted into international money, and, indeed, have proved to be a source of embarrassment to the Government in periods of weak exchange. This led to the unparalleled difficulties of the Government of India in 1918, and necessitated the purchase of large quantities of silver at abnormally high prices involving a correspondingly heavy loss on the Indian Exchequer.

(b) It has locked up the gold reserves in a form which admittedly involves difficulties in realising them.

(c) It has been the cause of grave misunderstandings between the Government of India and the public in India, misunderstandings for which the Government cannot possibly be blamed, and which can only be regarded as natural, and inevitable under the circumstances, on the part of the people of India. The policy of secrecy adopted has aroused serious distrust in their minds of the system as a whole. This distrust having continued over a period of a quarter of a century cannot be removed without whole-hearted measures. It is true that the policy adopted has earned for India a certain amount of interest on her reserves. It is stated* that, up to the 31st March, 1925, the net profit on investments has been £17,962,466 in interest and discount, after allowing for losses due to depreciation in value. The loss on sales of Reverse Bills in India exceeds Rs. 22 crores.† Besides this, one has also to take into account the effect produced on the public mind by the inability of the Government to realise at critical junctures the securities in which the reserves have been locked up.

The Secretary of State's object.

48. The late Sir Lionel Abrahams, who was examined at some length by the Chamberlain Commission, gave his reasons for every step that was taken. It is not necessary for me to go into the details of this explanation. The one outstanding impression that it leaves on my mind is that the Secretary of State was bent on earning for India all the revenue that he could by way of interest on the Reserves without deliberately breaking any existing statute. Indeed, there was, and is still, no statute to break. He continued to make investments in securities, instead of keeping the reserve funds of India in gold. The object that the Secretary of State had in view—the maximum financial advantage to India—was unobjectionable *per se;* but it was energetically pursued, against the representations of the Government of India, with complete disregard for the stability of the Indian currency system and the confidence which would have resulted from a substantial holding of liquid gold which was definitely prescribed and accepted. Sir Lionel Abrahams himself admitted in reply to Question No. 833 that "at certain times the markets in London for the sale of securities are extremely difficult."

* See p. 20 *East India: Accounts and Estimates.* Cmd. 2498.

† See p. 155 Council of State Debates, Vol. III., No. 14.

The Attitude of the Bank of England.

49. Another witness before the Chamberlain Commission. Mr. Clayton Cole, till then Governor of the Bank of England, protested against the disturbance caused by the loaning of the Indian (Currency) Reserves in London. He said in reply to Question 3348: "I think it is objectionable to have large sums of money raised in London which are, so to speak, not in any sense required for English trade. The loans in the market of the Indian Government are very large. I had the figures taken out the other day at the bank, and I find that the amount they are lending now through their broker is approximately 11 millions. That is money which, in the London money market, you can hardly describe as good money, because it is liable to be withdrawn for reasons which have nothing to do with what I call the London market. The India office lend the money at the best rate they can get, quite independent of what I call the considerations affecting the London market proper; therefore, that money may be lent, and is at times lent, in a way which is disadvantageous certainly to the Bank of England, which has to look after the gold reserves of this country." Such was the attitude of the Bank of England towards money lent in the London market to earn interest for the Reserves of India, a matter which naturally aroused suspicion in India.

II.—A GOLD STANDARD FOR INDIA.

50. The Fowler Committee recommended, and the Government adopted, a gold standard, based on gold reserves and a gold currency, as the currency system of India. I do not think that it is possible to improve upon the ideal of a gold standard based on gold reserves; and my colleagues agree in this. But it is now contended that since 1899, when the Fowler Committee reported, modern monetary practice has made a considerable advance, and that metallic gold need not form so large a part of the currency reserves under a real gold standard to-day as was believed to be necessary 27 years ago. We have, however, always to keep in mind the special circumstances of India. She has to-day sterling and rupee securities equal to about four and a half times the value of her gold coin and bullion in reserve. It is neither feasible nor desirable that the sterling securities should be realised and converted into gold forthwith, or in any manner other than the safest and most gradual to the markets of the world. The proportion of gold to securities in the currency reserves, set out in Paragraph 145 of the Report, demonstrates the necessity of the free inflow of gold into India being permitted in the normal course.

The importance of the free inflow of gold.

51. It has, however, been claimed that for the speedy reconstruction of the currency systems of other important countries disturbed by the War the greatest possible economy should be exercised in drawing on the world's stock of gold. The co-operation of these other countries in this connection, either with each other, or with India, is, however, neither assured, nor within sight, so far as I am aware; each is pursuing its individualistic national policy. If at any stage an international agreement should be framed for the economical distribution of the world's gold supplies I am confident that India would be prepared to exercise self-denial in her gold repuirements in proportion to that of other countries whose currency reserves were parallel to her own. But it is of paramount importance that any regulation of the inflow of gold should never be attempted by executive action, or by the currency authority. The main principles of the gold standard should be embodied in statutes, and

varied, if necessary only by *tmendment to such statutes, i.e.*, with the fullest publicity and the concurrence of the Legislature. India is fully alive to the commercial importance of sound monetary systems in all the principal countries, and given the safeguards I have indicated, will always be ready to play her part in the proper co-ordination of the monetary policy of the world. On the other hand if any discretionary power vested in the currency authority* is used to interfere with the free inflow of gold, without legislative sanction, certainly for the next few years at least, the old suspicions regarding the currency policy will be revived, and the miasma of distrust, which we are anxious to dissipate, will be raised anew.

52. Non-interference with the free inflow of gold into India, except with due publicity and the concurrence of the Legislature, is, therefore, to my mind of paramount importance. I regard this as the foundation of the Indian currency system we are recommending and as the most vital factor in ensuring the fullest confidence of the people in the policy adopted. Confidence is one of the two essential desiderata in any reform of the currency system; and this view has the support of Sir Basil Blackett, the Finance Member. Subject to the condition outlined above being unequivocably guaranteed, I am in agreement with the gold bullion standard as recommended by my colleagues.

Demonetisation of the Sovereign.

53. My colleagues regard the demonetisation of the sovereign and the half sovereign as a necessary part of that standard. The sovereign and the half sovereign are the only gold coins legally current in India since 1893. I regret that I am unable to appreciate the necessity of this recommendation. I am not aware that any other countries, with a gold standard, and a central bank as the currency authority, have found it necessary to demonetise their gold coin. Indeed, several witnesses in London have expressed doubts whether either England or America would be prepared even to consider the adoption of such a course. But as nine of my colleagues are convinced of the necessity of demonetising the sovereign and the half sovereign as essential to the establishment of a gold bullion standard, I am prepared to view with diffidence by inability to see eye to eye with them, and do not press my objection beyond recording my own opinion.

My colleagues hope that when the gold reserves of India are adequate, the people of India may not want a gold mint. I share their hope. But if when that stage is reached other important countries have not demonetised their gold coin, then we must, human nature being what it is, be prepared to find the India Legislature asking for a gold mint, though, in all probability, gold coin will be as little used in India then as it now is in the West.

A PROPOSED SCHEME FOR A GOLD CURRENCY.

55. I think it necessary to record the very laudable departure made by Sir Basil Blackett in the history of the Government of India, by appearing before us personally at the very start of our deliberations to give us the benefit of his expert knowledge and experience of the requirements of India, and his own views as to the most suitable currency system for the country. He also allowed two important officers of the Finance Department of the Government of India to appear before us in their

* As recommended in Pars. 104 and 166 of our Report. *Vide* Despatch No. 51, dated 24th April 1914, from Secretary of State to Government of India, Enclosure: "Note referred to in 4n"—Appendix 97.

personal capacity, and the difference in views expressed by him and by Messrs. McWatters and Denning only serves to show that the latter were expressing views without being trammelled by office or tradition.

Grounds for Rejection.

56. While I subscribe to the conclusion arrived at by my colleagues in regard to Sir Basil Blackett's scheme, I cannot but disagree with some of the reasons adduced in support of that conclusion. In the first place, I do not believe that the introduction of a gold currency can jeopardise the note circulation, except perhaps at the outset, when popular curiosity may create a certain amount of demand for gold currency. Such curiosity, however, would only be small in extent and temporary in duration. Instead of the replacement of notes by gold currency, as apprehended, the ready convertibility of notes into gold will, if anything, increase the confidence of the people in paper currency, and to that extent promote its circulation further. In the second place, I cannot agree with the observation that "the mere act of putting gold into circulation would not develop the banking and investment habit" in India. I agree with Sir Basil Blackett when he said that "the introduction of gold into circulation, although it is a wasteful and expensive system, is necessary in Indian conditions to inspire confidence in the people, and provide the stimulus which is badly needed for investment and the banking habit in India."

57. The two essential desiderata in any reform of the currency system of India are, according to Sir Basil Blackett, and as also accepted by my colleagues, "that the Indian people should have full confidence in their currency, and that the system should be reasonably intelligible to them." I have no hesitation in accepting Sir Basil Blackett's recommendation that the quickest and best method of ensuring this confidence is by making the internal currency absolutely convertible into gold coin at the will of the holder, as a necessary step "in the direction of the still more ideal form of currency, *viz.*, and international Exchange Standard by which I mean a paper currency inconvertible internally, but freely convertible on a gold basis for external purposes."

58. It remains only to emphasise that Sir Basil Blackett has based his calculations of the cost of his scheme for a gold standard and a gold currency on assumptions which throughout have deliberately been made to err on the side of safety. The actual cost would, according to him, be considerably less than his estimate of Rs. 1¾ crores per annum for the first five years and from Rs. 61½ lacs to Rs. 112 lacs per year thereafter. The apprehension that the cost to India will be increased by an indefinite and an incalculable amount due to the replacement of notes by gold is, as mentioned above, groundless and need not seriously be considered.

59. The Fowler Committee had considered a suggestion made to it to borrow for the purpose of introducing a gold currency. But they rejected the suggestion. There may be people to-day anxious to disregard the increased cost involved in the introduction of a gold currency by this method, particularly in view of the departures made from the Fowler Committee's recommendations, in preference to a gradual process of acquisition of gold. The only reply to such impatient enthusiasts would be the advisability of India doing nothing to retard the reconstruction of devastated Europe, if it can be avoided by a slower and more natural process of accumulating gold for her requirements.

60. All the same, even though I also cannot accept Sir Basil Blackett's scheme, I should like to record my sense of appreciation of the service that he has rendered to India in clarifying once for all, with the weight of his knowledge and experience, the fundamental requirements of her currency system.

III.—A CENTRAL BANK FOR INDIA.

61. The main question to be determined in regard to the authority to which shall be entrusted the working of the Indian currency system is whether, as recommended by my colleagues, a new Bank should be started, *to exercise the functions of a Central Bank*, or whether the Imperial Bank of India, which now performs some of the functions of a central bank, shall be developed into the Central Bank of India. The first scheme would involve the existence of two banks working side by side, each supported, wholly or in part, by the user of the Government balances. Whilst fully appreciating the reasons which have induced my colleagues to propose the creation of a new central bank, and recognising that this is perhaps the ideal system. in the special conditions of India I am of opinion that the ends in view, for as far ahesad as we can see will be better served by developing the Imperial Bank of India into a full-fledged central bank. It is contended that if the Imperial Bank of India is developed into a central bank, some of its commercial activities will be curtailed. I apprehend no serious curtailment. On the other hand, I consider that such curtailment of the commercial business of the Imperial Bank which might follow its conversion into a central bank would conduce to the growth of new banking institutions, started by private enterprise in India. The bulk of the business laid down for the proposed new Central Bank can all be transacted by the Imperial Bank of India as the Central Bank. In some cases, it would only necessitate a change in the method or form of its business.

Suitability of the Imperial Bank of India.

62. It is said that if the Imperial Bank is developed into a Central Bank "the country would lose the benefit of the elaborate and wide-spread organisation which has been set up through the length and breadth of India to make available to *the community the increased* commercial banking facilities which are so urgently needed and to assist in fostering among the people as a whole the habit of banking and investment." I do not think that this necessarily follows; it is only necessary to mention the model of the Bank of France, which successfully discharges both the functions of a Central Bank and those of "the initiator of banking facilities" through more than six hundred branches. It is admitted that in India none but a State-aided bank has either found it possible systematically to develop branches, or is likely to be able to do so in future. The importance of spreading banking facilities throughout the length and breadth of the land needs no emphasis. Every previous currency inquiry has laid stress upon it; but from the time of Mr. Hambro's minute in the Fowler Report of 1899 till to-day the progress has been lamentably slow. The bank in India with the largest number of branches is the Imperial Bank; the number of these is only a hundred and sixty-four, yet witnesses of authority have stated that India needs thousands of branch banks. It is imperative that the Government of India should for years to come regard the rapid extension of banking facilities as an essential and urgent part of its financial policy. This can be accomplished only through the strongest banking institution in the country. No rival therefore should be allowed to impair the prestige and authority of the Imperial Bank of India, and no division of the Government funds between it and another institution should be permitted to restrict its capacity to open new, and even temporarily unprofitable, branches which are essential to the mobilisation of the resources of the country.

63. Moreover, I do not see at present, or for several years to come, any scope for two banks working side by side, one fully, and the other partially, with Government support. My colleagues recommend that

the new Central Bank should only re-discount drafts. The present currency and popularity of drafts in India is limited, though they are not by any means a new feature in its banking system. In fact, they have been used for generations; but, during the last 50 years or more the tendency has been to work on credits on the lines of the Scotch banks. The system recommended by my colleagues may perhaps be evolved in course of time; but for the present there will be comparatively few bills available to the Central Bank, and certainly fewer still, if any, with the signatures of banks. For, at the moment, the most active banks in India are the Exchange Banks which would go to the Central Bank to re-discount external bills—they do not discount internal bills, or *hundis,* to any appreciable extent—only when the Central Bank rate for re-discounting is lower than the discount rate in London. Judging by past experience, I do not foresee such a contingency; and I fear that the Central Bank may find very little business available to it, unless it competes with the Imperial Bank. My apprehension, therefore, is that either the Central Bank and the Imperial Bank will have to compete with each other, or the Central Bank will not find sufficient scope for business to employ its funds. Either result would, to my mind, be undesirable. My question, therefore, is: Why multiply, if it can be avoided, institutions, supported by Government balances?

64. On these grounds, therefore, I recommend the evolution of the Central Bank from the existing Imperial Bank of India, instead of by starting a new bank in addition thereto as recommended by my colleagues. This would necessitate restriction of the earnings of the Imperial Bank of India. Such a restriction would necessarily be confined to the present rate of dividend, as the minimum, because the Imperial Bank has been earning it for several years. Over and above that minimum the increased dividend should be limited to 2 per cent. on the lines recommended in the scheme outlined by my colleagues. Unless the shareholders of the Imperial Bank agree to such restriction of their dividends, there will, of course, be no alternative left but to start a new Central Bank.

IV.—STABILISATION OF THE RUPEE.

65. My colleagues recommend that "the rupee be stabilised in relation to gold at a rate corresponding to an exchange rate of 1*s.* 6*d.* for the rupee." The main grounds on which this proposal is made is that one shilling and sixpence is the *de facto* ratio, and that prices, wages, contracts and public finances, in other words, conditions generally, have either substantially adjusted themselves to it, or "the least injury will be done to all interests by adhering to that rate." I am unable to accept any of these premises, nor the conclusion it is sought to draw from them.

(i) THE "DE FACTO" RATIO.

66. The legal standard of money payments in India recommended by the Herschell Committee in 1893 was one shilling and fourpence to the rupee. That standard was accepted by the Fowler Committee in 1899, and officially adopted by the Government of India. It remained the effective standard until the 28th of August 1917, when, in consequence of the abnormal rise in the price of silver caused by the War, the Government of India raised the rates for the sale of Council Drafts to correspond roughly to the price at which silver for coinage could be bought. The Babington-Smith Committee recommended, in their report, dated the 22nd of December 1919, that an entirely new ratio of 2*s.* gold to the rupee should be established. The Government of India, despite earnest entreaties in the Imperial Legislative Council, passed the legislation necessary to establish the rupee at 2*s.*

gold in September 1920, when the actual rate was 1*s.* 4$\frac{5}{16}$*d.* gold, and gold prices were slowly, but unmistakably, falling. This rate, which was placed on the Statute Book, was neither the *de facto* rate, nor was it warranted by world conditions. The operations undertaken to establish and maintain this unnatural rate were:—

(*a*) Sales of Reserve Councils, £55½ millions.

(*b*) Deflation in India to the extent of Rs. 35 crores.

The Government of India dared not prosecute the experiment after these operations. The attempt to stabilise the rupee at 2*s.* gold was abandoned; and the value of the rupee was allowed to adapt itself to market conditions without any further attempt artificially to control it. India reacted to the violent fluctuations in prices in other parts of the world, and the rupee varied from 11$\frac{3}{32}$*d.* to 1*s.* 3⅝*d.* gold, from August 1921, to September 1924.

The Opportunity of 1924.

67. When, in September 1924, the rate was approximately 1*s.* 4*d.* gold (it ranged during the month between 1*s.* 5½*d.* and 1*s.* 6*d.* sterling), suggestions were made officially to the Government, in the Legislative Assembly, to restore this ratio to the Statute Book, in place of the fictitious ratio of 2*s.* gold. The Government of India declined to favour these proposals. Their telegram of the 11th of October 1924 (when exchange was about 1*s.* 4¼*d.* gold) to the Secretary of State shows that their policy then was to look for, in their own words, "a permanently higher rate than 1*s.* 4*d.* gold." Subsequently, when in April 1925 the pound sterling reached gold parity, the Government of India were able to talk* of this new ratio as 1*s.* 6*d.* gold, instead of 1*s.* 6*d.* sterling. The unavoidable conclusion is that the Government of India could have stabilised the rupee at 1*s.* 4*d.* gold in September 1924, thus restoring the long-established legal standard of money payments, if it had chosen to do so.

How the rate of 1s. 6d. was reached.

68. It has further to be considered how the rate of 1*s.* 6*d.* sterling was attained. The pre-war average expansion of currency in India was over Rs. 20 crores per annum. During the last four years the net expansion or contraction has been as follows:—

In Crores of Rupees.

Year.	Rupees and Notes.	Sovereigns.	Nett.
1921-22	— 1	+ 3	= + 2
1922-23	— 6	+ 9	= + 3
1923-24	+15½	+ 7	= + 22½
1924-25	+ 1	+15	= + 16
			+ 43½ crores

The average expansion was therefore 11·12 crores a year. No wonder that the Imperial Bank of India rate went as high as 8 per cent. towards the end of 1923, and remained there for the first half of 1924, money in the chief trading centres of India being not available even at that rate during the period! Indeed, in the Viceroy's telegram to the Secretary of State, dated the 8th of October 1924, it is admitted "that the stringency in the market is the direct outcome of Government action in contracting

**Vide* Appendix 98. Telegrams from Viceroy to Secretary of State, dated 8th October 1924 and 11th October 1924.

currency, or rather in placing strict limits on possibilities of expansion . . . . We should have difficulty in refusing to provide more generously for additions to currency even if we wished to do so and there is serious risk of a financial crisis if we keep the screw on too tight."*

69. In fact, the efforts of the Government in preventing the normal expansion of currency had reached such a stage by October 1924 that the Secretary of State expressed himself as follows in his telegram† to the Viceroy, dated the 10th of October 1924:—

"It seems to me however, that the vital consideration is not so much the actual level of exchange at the moment as the avoidance of such abnormal stringency as might threaten the financial and economic position."

Thus ratio of 1*s*. 6*d*. sterling was attained by official administration of the currency.

70. Whilst the currency was being administered in this manner, the natural corrective to rise in Exchange—the tender of gold at the Currency Offices—was made impossible for practical purposes by the retention of the fictitious ratio of 2*s*. on the statute book. The gold imported into India as genuine cover for her favourable balance of trade could not function as currency‡ and was a mere commodity. Under such conditions, and by such actions, it was within the power of the Government of India to establish almost any rate, and to maintain it for a time.

71. It might be contended that the ratio of 1*s*. 6*d*. has been established since October 1924, and that therefore it should be accepted as the *de facto rate*. Le us, however, be quite clear about this. Sterling was not on parity with gold in recent years till June 1925. From October 1924 onwards the rupee was not 1*s*. 6*d*. gold, but 1*s*. 6*d*. sterling. The rupee did not reach 1*s*. 6*d*. gold till June 1925, when sterling reached gold parity, and this rate has, therefore, now prevailed only for a year.§

72. Account must also be taken of the manner in which the rupee has been maintained at 1*s*. 6*d*., even in the very favourable conditions of the day, when India has experienced four good harvests in succession. From March 1926, there was a visible lull in exports, believed to be temporary and the rupee immediately sagged. Possibly this tendency was later aggravated by speculation but the subsequent history of the Exchange does not indicate that such speculation, if there was any, was a serious, or more than a temporary factor. The rupee was maintained at 1*s*. 6*d*. only by the deflation of the currency by Rs. 8 crores, during April last, and by an offer by Government through the Imperial Bank of India to sell Reverse Councils at 1*s*. 5¾*d*. It has been argued that as Government used its resources to prevent the rupee from rising *above* 1*s*. 6*d*. sterling since October 1924, conversely, it was justified in taking administrative action to prevent it from falling *below* 1*s*. 6*d*.¶ I cannot accept this contention. Unlike other countries with their currency, Government deliberately rejected the opportunity of stabilising the Rupee at its pre-war ratio, when reached. Insisting as they did on retaining the legal fictitious ratio of 2*s*. Government prevented gold from being tendered at the currency offices in settlement of India's balance of trade. They thus exposed the Indian exchange to the risk of a rise to any height (*see* telegram from the Viceroy to the Secretary of State, of the 11th of

* See Appendix 98. Telegram from Viceroy, 8th October 1924.

† See Appendix 98. Telegram from Viceroy, 10th October 1924.

‡ See Appendix 98. Telegram from Secretary of State, 15th October 1924.

§ The rates ruling in September and October 1924, were as under:—

September: 1*s*. 5 7/32*d*. sterling = 1*s*. 3⅞*d*. gold.

October: 1*s*. 5 23/32*d*. sterling = 1*s*. 4¼*d*. gold.

¶ *Vide* Appendix 98. Telegram from Secretary of State to Viceroy, 19th November, 1924.

October 1924), and it is a mercy that they did not select a higher rate than 1*s*. 6*d*. at which to intervene. That does not, therefore, afford any justification for administrative action to prevent the rupee from finding its natural level downwards. Indeed, if it is contended that the course of the rupee both ways can justifiably be regulated by manipulation, there was no necessity to refer to this Commission the question of the ratio which has been made a *fait accompli* by administrative action, as foreshadowed by the Secretary of State himself* in his telegram to the Viceroy of the 24th of September 1925. And, under the circumstances, this Executive action must be regarded as calculated to prejudice both our enquiry and our findings.

The Ratio and the Legislature: a Pledge.

73. It is true that there is no Statute governing the selling of Reverse Councils; but it will be recalled that after the fruitless and prodigious sales of 1920, Sir Malcolm Hailey, then Finance Member, gave an undertaking to the Legislative Assembly, on the 24th of January 1922, in the following terms:—

"But there may nevertheless still be some who fear that we may be intending to use these reserves artificially to raise exchange. Now the method by which we could utilise these reserves would, of course, be only that of re-opening the sale of Reverse Councils: and I can give the Assembly this much guarantee, at all events, that we should not re-open the sale of Reverse Councils in order to maintain exchange or to raise exchange in the manner suggested, without first coming to this Assembly."†

I consider that the recent Executive action in making an offer for the sale of sterling, as it is put, is nothing but an offer by Government to sell Reverse Councils, without using these words. The Assembly was in session till the end of the third week in March last, and exchange had shown signs of weakness even then. The Government of India in their telegram‡ of the 19th of March, to the Secretary of State, referred to what they called the recent "pronounced weakening of exchange" which "makes it desirable that we should be prepared for possibility that exchange may decline to lower gold point as determined on basis of 18*d*. gold rupee." The Government could well have approached the Assembly for their concurrence in offering to sell Reverse Councils, or to sell sterling, as it is put, on a contingency arising. In relation to the Assembly, therefore, this action on the part of the Executive was nothing short of a breach of faith.

74. It is important at this point to mention that the Legislature in India has shown a sustained interest in the question of a suitable ratio for India in place of the ineffective 2*s*. ratio. The late Sir Vithaldas D. Thackersey moved a resolution in the Assembly on the 24th of January 1922, and a full report of the debate raised on it is given in the Assembly Debates, Vol. II, No. 21. Sir Malcolm Hailey assured the mover of the resolution that "our power of rapid deflation is by no means considerable," and repeated that "when the Secretary of State sells Council Bills he ceases to have any power to raise exchange." Sir Vithaldas Thackersey, replying, expressed his fear that "when the opportunity occurred," the Secretary of State would use his power to manipulate exchange. Even with the guarantee that Reverse Councils would not be sold until the Assembly had been consulted, he urged that exchange could artificially

* *Vide* Appendix 98. Telegram from Secretary of State to Viceroy, 24th September 1925.

† *Vide* Assembly Debates, Vol. II, No. 21, 24th January 1922.

‡ *Vide* Appendix 98. Telegram from Secretary of State to Viceroy, 24th September 1925.

be raised if the Secretary of State refused to sell Council Bills when trade demand arose. Sir Malcolm Hailey reiterated that in the circumstances the Secretary of State's power to influence exchange was very small.

75. In March 1921, in a debate in the Council of State, the Financial Secretary to the Government stated: "If there is going to be any fundamental change, any new rate to be settled or any attempt at a permanent solution, neither the Government of India nor the Secretary of State will do this off his own bat."

76. Events have justified the apprehensions of Sir Vithaldas Thackersey. Deflation has not yet taken place by the methods which he feared, *i.e.*, by sales of Reverse Councils or the withdrawal of the Secretary of State from the market. But deflation, and a consequent raising of exchange, has been accomplished by preventing the expansion of the currency to the extent normally required by India, as evidenced by the pre-war annual average of expansion. In fact, the Government of India themselves pleaded with the Secretary of State in Paragraph 3 of their telegram* to him of the 4th of November 1924, when they pressed for authority to prevent the exchange rising above 1s. 6*d*. in the following words:—

> "We doubt whether sufficient weight has been given by you to the great improvement in internal economic conditions which has taken place in India, and to the check which in the last few years has been placed on the expansion of currency. In the last two years the raw materials of India have been in great demand, with the result that there has been a substantial trade balance in her favour."

In a word, India has been starved of her natural currency requirements and this operation, being equivalent to deflation, has been effective in raising the rate of exchange.

Authoritive Views on Artificial Measures.

77. Two distinguished authorities in the financial word, the Right Hon. Montagu C. Norman, Governor of the Bank of England, and Mr. Benjamin Strong, Governor of the Federal Reserve Bank of New York, have expressed their views on the question of the ratio as follows:—

Q. 14,385. *Sir P. Thakurdas:* It does not matter, then, in your opinion, whether the present rate is stabilised by natural means or by something which is artificial?—*Mr. Montagu Norman:* If I was aware of the existence of an unnatural position which had resulted from the adoption of exceptional measures, that might change my view; but, as I understand it, though I have not studied the question, it has been generally speaking by natural causes that the Indian exchange has come to be where it is, and to remain there over a long period; and I see no reason to advocate that it should be altered.

Q. 15,473. *Chairman:* Are you able to consider the matter from the point of view of the statistical position of the reserve?—*Mr. Benjamin Strong:* I should say that the three main considerations would be first, the domestic readjustments to a given price of the rupee; the extent to which any artificiality has entered into the management of the external price; and the size of the reserve.

I wonder if these two eminent authorities would have much doubt about the nature of the conditions under, and the measures by which the rate of 1*s*. 6*d*. has been attained and maintained.

* *Vide* Appendix 98. Telegram from Viceroy to Secretary of State of 4th November 1924.

78. On all these grounds I am strongly of opinion that any recommendation to fix the rupee at 1s. 6d., because it is the *de facto* rate, is not *per se*, entitled to the slightest weight. The ratio of the future must be decided on weightier considerations.

(ii) ADJUSTMENTS TO A 1s. 6d. RATIO.

79. The main point for examination is whether there are any economic adjustments to the current rate of Exchange still incomplete, and which, after stabilisation of the rupee at 1s. 6d. will involve a disturbance of existing conditions. Such an examination should be in the following directions:—

(1) Whether the adjustments are complete, and if incomplete, in what directions.

(2) In the latter case, the period required for complete adjustment.

80. No evidence has been forthcoming, even from experts, as to the time necessary in India for the essential adjustments to take place. Mr. Keynes, in a brochure issued when Great Britain returned to the Gold Standard, in April 1925, indicates that in a country like the United Kingdom, a period of about two years is necessary for adjustments to take place to a 10 per cent. variation in Exchange. If this is so in a country the bulk of the trade of which consists of exports and imports, compared with which, the internal trade is small, in the case of India, where the proportions are reversed,* the period must undoubtedly be longer.

81. The important directions in which adjustments have to be sought should include at least the following—

(I) Prices.

(II) Wages.

(I) PRICES: *General Considerations.*

82. It is a historical fact that prices rise during wars, and gradually fall after peace. The Babington-Smith Committee was led into believing that prices would remain more or less on the high level at which they stood at the end of 1920; and that was an important ground on which they recommended a ratio of 2s. gold to the rupee. Since then, prices have fallen. The consensus of opinion, both in the United Kingdom and in America, appears to be that the present level of prices will at best only be maintained. Where a doubt about stability in the future was expressed, it was in the direction of a fall. No one has ventured to predict that gold prices will rise; the monetary reconstruction of European countries and their economic recovery, and the present isolation of Russia, are such important factors, that this is not apprehended.

83. For the purpose of this examination the prices that have to be taken into consideration are (1) prices of articles exported from India: (2) prices of articles produced and consumed locally; (3) prices of imported articles.

Articles of export.

Regarding (1) articles of export, the bulk of these have to be sold in competitive world markets, and their prices, governed by world prices, automati-

* *Vide* Appendix 26—Dr. Balkrishna's written statement, "Domestic trade *versus* foreign trade."

cally adjust themselves, practically from day to day, to the prevailing rate of exchange. Even in the case of articles like jute, in which India enjoys a monopoly, there is an upper limit of price beyond which the effective use of substitutes is resorted to. If, therefore, the rupee is appreciated to a point at which, during the period of non-adjustment, the Indian cultivator cannot reduce the prices of exportable articles to the world level, he will miss the world market when there may be a demand for his produce. He must either sell his produce at once at a loss, or be forced to hold on for a better price, which, however, would expose him to the risk of having to sell his produce later, at a time when the world's demand has been met from other sources, and consequently to accept a still more unremunerative price. He *must* sell his produce sooner or later, for his holding power is low.* While, therefore, price adjustment in the case of articles of export must be complete at any moment, and at any rate prevailing, the Indian cultivator is exposed to this serious risk pending adjustments in *other* directions.

Produce consumed locally.

84. Regarding (2) Indian produce locally consumed, this is not nearly as sensitive to exchange fluctuations. The higher or lower purchasing power of the rupee in terms of gold should ultimately be reflected in the prices of these articles, but the adjustment is neither automatic nor speedy. For instance, if the price of wheat in the world market falls, wheat sells at a lower price for local consumption in India. The great millets, Jowari and Bajri, consumed by the poorer classes in India, always sell at a price level below that of wheat. Should wheat fall so as appreciably to narrow the normal margin of difference, either the millets are sold more cheaply, or consumers may take to wheat. No one cay say at what point this substitution takes place, and it is difficult to estimate the time or the extent of the narrowing of the margin between these staples. But it is beyond doubt that everything else, such as seasonal conditions, being normal, the reaction of prices of Bajri and Jowari to a fall in the price or wheat would take a considerable time.

Articles of Import.

85. Regarding (3), articles of import, it is true that a higher exchange would make these articles available to the consumer in India at a lower rupee price. To that extent, the consumer benefits; but here the question arises as to the proportion of imports which are consumed by the masses of India. This has been given at various percentages of the total imports of India, the highest being 40 per cent. and the lowest 7 per cent. In the absence of official information, one can only name these two extreme estimates.

86. The conclusion to be drawn from these premises is that while adjustment in the price of articles of export to the rate of exchange, is complete at any time, until the other adjustments are complete, the producer is exposed to serious risk of loss. For articles entering into the internal trade, the proportions of which are many times larger than the external trade, no reliable data are available of the adjustments that have taken place till now to the pre-war rate of exchange. These are only assertions without proof. Regarding imported articles, the benefit from a higher exchange is immediate; but the proportion of such benefit accruing to the masses is very small, estimates ranging between 7 per cent. and 40 per cent. of the imports.

* Compare Fowler Committee Report, p. 25 middle paragraph, Minute of Dissent by Mr. Robert Campbell and Sir John Muir.

The Course of Indian Prices.

87. In the light of these general considerations, it is instructive to examine the recommendation that the rupee should be stabilised in relation to gold at a rate corresponding to an exchange rate of 1*s.* 6*d.* for the rupee. The chief reason advanced by my colleagues in support of this recommendation (Paragraph 176 of the Report) is their conviction that at the present rate of about 1*s.* 6*d.* " prices in India have already attained a substantial measure of adjustment with those in the world at large, and as a corollary that any change in the rate would mean a difficult period of readjustment, involving widespread economic disturbance, which it is most desirable in the interests of the people to avoid, and which would in the end be followed by no countervailing advantage." While recognising that " index figures are not an infallible guide, and that there are many directions in which they might lead one astray," they consider that such figures are " more reliable in indicating the trend of prices in each single country than in comparing the relative levels of prices in two or more countries."

The Arguments of my Colleagues.

88. Treating the statistics " in the most generalised way " they observe that during the eighteen months from December 1922 to June 1924, when the rupee was worth about 1*s.* 3*d.* gold, the rupee price level ranged round a mean of about 176; that in the succeeding year, when the rupee was rising to 1*s.* 6*d.* gold, the rupee price level fell below 160, since when, while the rupee has remained round about 1*s.* 6*d.* gold, the rupee price level has ranged round a mean of about 158, with recent tendency to fall in sympathy with world prices. They then proceed by means of a graphic representation (Figure 1) to show that prices in India in terms of *gold* have, since the middle of 1922, generally moved parallel to movements in world prices in terms of gold. This is, of course, as it should be; for after all, there is such a thing as a world price level measured in terms of gold, to which prices in any country, measured also in terms of gold, must in general trend correspond, if not in actual level. If Indian prices in terms of gold have moved approximately parallel to world prices in terms of gold, English prices in terms of gold have done the same. I shall therefore confine myself to movements in India rupee prices.

Sir Basil Blackett's Argument.

89. Sir Basil Blackett in the evidence that he gave before us on the 24th of November, 1925, also contended that " substantial equilibrium of prices had been attained " to a rate of 1*s.* 6*d.* because " British American and Indian prices have come together at a figure about 160." (Q. 27.) He added, however: " But I am not quite sure what value is really to be attached to any of these index numbers, and particularly to the Indian one. It is hard to be sure that it is completely valid. At the same time it does suggest that prices have now come together . . . You will see that there is a considerable fall in Indian prices under certain heads when you get into details." (Q. 27.)

90. The argument was that because the index numbers of wholesale prices, in India (in rupees), in the United Kingdom and the United States of America (in gold) were at the moment all at about the same level, Indian rupee prices had " generally speaking " adjusted themselves to 1*s.* 6*d.* If there is any value to be attached to index numbers—and Sir Basil Blackett is " not quite sure " what value can be attached to them—they lead to a very different conclusion.

The Course of Prices from June, 1925.

91. Early in June, 1925,* the rupee touched 1*s*. 6*d*. gold. The Calcutta index number for that month was 157. For February this year the number was 158, and for March 155. In between, it was 160 for July, 157 for August, 158 for September, 160 for October, 164 for November and 163 for December and January. In other words, after the rupee touched 1*s*. 6*d*. gold in June, 1925, for six months there was a progressive rise. (And even in March, 1926, the level was only two points lower than in June, 1925.) On the other hand, sterling reached its pre-war parity also in June, 1925. The index number of sterling prices for that month was 158. Since then it steadily fell to 149 in February, 1926. In other words, since sterling reached gold parity there was up to February, 1926, a fall of nine points in the British index number, compared with a rise of one point in the Calcutta number as between June, 1925 (when the rupee also touched 1*s*. 6*d*. gold), and February, 1926.

92. Taking Bombay prices, from July, 1925 (on the first of July the rate was 1*s*. 6$\frac{1}{16}$*d*.), to February, 1926:

(1) Bombay wholesale prices fell from 158 to 152, *i.e.*, 6 points;
(2) U. S. A. gold prices fell from 160 to 155, *i.e.*, 5 points;
(3) United Kingdom prices fell:—
  (*a*) *Board of Trade*†—157 to 149, *i.e.*, 8 points.
  (*b*) *Economist*†—165 to 154, *i.e.*, 11 points.
  (*c*) *Statist*†—158 to 150, *i.e.*, 8 points.

It would appear, therefore, that the fall in Bombay prices was due to the fall in gold prices themselves, and not to any adjustment of Indian prices to 1*s*. 6*d*.

93. The course of Calcutta prices in this period may perhaps be due to the predominance of jute and tea in the Calcutta index number, and to the marked fluctuations in jute during that period. Omitting these two commodities from the Calcutta number, the fall between July, 1925, and February, 1926, was 5·3 points, a figure which corresponds very closely to the fall in Bombay prices, and in gold prices themselves, and reinforces the conclusion that such a fall is no part of an adjustment of prices to the higher exchange rate of 1*s*. 6*d*. In other words, it cannot be contended that there has been any adjustment in Indian prices *since* the Rupee touched 1*s*. 6*d*. gold in June, 1925.

The Course of Prices from December, 1922, to June, 1925.

94. I shall now examine the contention in Paragraph 187 of the Report that the fall in rupee prices in the first half of 1925 represents "the tendency of those prices to adjust themselves to the rise in exchange." Starting from December, 1922, the point from which my colleagues begin their examination

* (*a*) We had before us a statement from which I have taken the figures used by me in this note. The figures relied on by my colleagues are also based on the same statement. These are taken from the following sources:—

Dollar-Sterling Exchange rates from the London and Cambridge Economic Service Bulletin.

Rupee-Sterling Exchange rates from the average of the Daily Bombay quotations from the *Times*.

Rupee-Dollar Exchange rates from the Federal Reserve Bulletin.

United Kingdom wholesale prices from the Board of Trade Index Number. (1913=100).

United States of America wholesale prices from the Bureau of Labour Statistics. (1913=100).

Calcutta Index Number wholesale prices from the Indian Trade Journal. (31st July, 1914=100).

Bombay Index Number wholesale prices from the Labour Gazette. (July, 1914=100).

of the course of Indian prices, the gold parity of the Rupee rose from 95 in that month to 113 in June, 1925, the world gold prices were about the same level at the beginning and at the end of the period— to be exact, 156 and 157 respectively. On the rise of the gold parity of the Rupee during this period from 95 to 113, *i.e.*, 19 per cent., adjustment of Indian prices to world prices, would in order to be complete have meant a corresponding fall of 19 per cent. in the Indian price level, *i.e.*, a fall of 33·5 points in the Calcutta Index number which was 176 in December, 1922. The actual fall, however, was from 176 to 157, or only 19 points. This proves that the adjustment till June, 1925, was only partial. An examination of the Bombay Index figures lead to exactly the same conclusion. I have already explained, that the fall in rupee prices *since* June, 1925, was only a reflection of a corresponding world fall.

(*b*) I give below an abstract from this Statement for the months referred to in the Report and by me.

INDIAN EXCHANGE AND PRICES.

Month.	Exchange.						
	Doller—Sterling Exchange.		Rupee—Sterling Exchange.			Rupee—Doller Exchange.	
	$	% Gold Parity.	Sterling.	Gold. s. d.	% Gold Parity.	$	% Gold Parity.
July, 1922	4·45	91·5	15·67	1 $2\frac{1}{16}$	90	28·89	89
December, 1922	4·62	95·0	16·00	1 $2\frac{17}{32}$	95	30·65	94
June, 1924	4·32	88·8	16·99	1 $2\frac{15}{16}$	94	30·49	94
July, 1924	4·37	89·8	17·19	1 $3\frac{1}{8}$	96	31·25	96
August, 1924	4·50	92·5	17·24	1 4	100	32·26	99
June, 1925	4·86	99·9	18·05	1 $6\frac{1}{16}$	113	36·48	112
February, 1926	4·86	99·9	18·19	—	114	—	—

Month.	Wholesale Price Indices.						
	U.S.A. 1913 = 100.	U. K. 1913 = 100.		Calcutta, 31st July, 1914 = 100.		Bombay. July, 1914 = 100.	
	Gold.	Sterling.	Gold.	Rupee.	Gold.	Rupee.	Gold.
July, 1922	155	160	146	181	163	190	171
December, 1922	156	156	148	176	165	175	164
June, 1924	145	163	145	176	165	185	—
July, 1924	147	163	146	179	172	184	—
August, 1924	150	165	153	180	180	184	—
June, 1925	157	158	158	157	177	160	—
February, 1926	155	149	149	158	180	152	—

(*c*) I have, however, not reduced the British and American figures to the July, 1914, base of the Indian Index numbers. For I am only concerned with the levels of the latter. Besides, as my colleagues have pointed out in para. 178 of the Report, " Index figures are more reliable in indicating the general trend of prices in each particular country than in comparing the relative levels of prices in two or more countries "; and, further, in para. 184 that the levels " may be influenced by factors (*e.g.*, the base year chosen for the compilation of Index numbers) which are largely irrelevant for the present purpose, whereas the general trend of movement would remain the same whatever basis was chosen for the figures."

† 1913=100.

The Course of prices from July 1922 to February 1926.

95. I should, however, like to take the whole range of price movements from July, 1922, to February, 1926. The world price level was exactly the same, *viz.*, 155 at the beginning and end of this period. The gold parity of the Rupee was 90 in July, 1922, and 114 in February, 1926, *i.e.*, an increase of 27 per cent. The Calcutta Index Number was 181 in July, 1922, and 158 in February, 1926, *i.e.*, a fall of 23 points. But on a 27 per cent. increase in the gold parity of the Rupee, a fall of 49 points was called for, to bring about complete adjustment of Indian to world prices. The actual fall, however, was 23 points. In other words, a fall of 26 points, or more than half the adjustment, was still to come in February, 1926, it being clear that recently "both rupee and world prices have been falling practically in unison," as stated in Paragraph 187 of the Report. Taking the average of the Calcutta and Bombay Index Numbers, instead of the Calcutta number alone, the July, 1922, average was 185, and that of February, 1926, 155. There has thus been a fall of only 30 points, against 50 (27 per cent. of 185) to be expected for full adjustment.

The Course of Sterling Prices.

96. It cannot, of course, be assumed that because the balance of adjustment has not yet taken place, India can permanently escape it. The experience of the United Kingdom shows that more or less complete adjustment must follow movements in exchange sooner or later. Taking the same period as I have in the preceding paragraph, the gold parity of Sterling stood at 91·5 in July, 1922, and almost at 100 (99·9) in February, 1926, *i.e.*, a rise of 8·4. There has thus been an increase in the parity of the pound Sterling of 9·2 per cent. Sterling prices in July, 1922, stood at 160, and in February 1926, at 149. I need not repeat that the world gold price lever stood at 155 in July, 1922, and at the same figure in February, 1926. There has, therefore, been a fall of 11 points in Sterling prices, as against 14·7 (9·2 per cent. of 160) points that we should have to look for. And sterling prices have been falling further since February, 1926.

Conclusion as to Rupee Prices.

97. When it is remembered that commodity prices *follow* a movement in exchange, and that there is always a lag in Indian internal prices and a delayed adjustment to external factors, it must be admitted that the greater part of the general adjustment to 1*s*. 6*d*. by a fall, is still to come.

If Gold Prices Fall?

98. If the rupee is to be now stabilised at 1*s*. 6*d*. that fall will be aggravated if gold prices themselves fall from the present level. The evidence of the distinguished witnesses from America indicates that America is anxious to maintain the present level of gold prices; that a rise is certainly not to be looked for; if anything, a fall is not improbable. My colleagues themselves in Paragraph 36 of the Report refer to the apprehension of two distinguished experts (Professor Cassel and Mr. Joseph Kitchin) in this connection. If gold prices fall—and Indian prices must follow such a fall—India will be faced with a still bigger fall—the double effect of the operation of the present rate of 1*s*. 6*d*. and also the world fall. I cannot but contemplate such a prospect with very serious misgivings, for it will hit the Indian producer to an extent beyond his capacity to bear. In a word, it will hit, and hit very hard, four-fifths of the population of the country that exists on agriculture.

(II) WAGES.

99. The main classes of wage-earners to be considered are:—

(a) The agricultural labourer.

(b) The industrial labourer.

(c) The middle-class and clerical workers.

Agricultural Wages.

100. (a) The latest figures available with regard to agricultural labour are in a Statement* submitted to us by Mr. Gennings, of the Labour Bureau in Bombay. He says that in the various Divisions of the Bombay Presidency the increase in the wages of labour in urban and rural areas between 1913 and 1925 has been as follows:—

	Per cent.
Field labourer, urban areas	121
Field labourer, rural areas	106
Ordinary labourer, urban areas	104
Ordinary labourer, rural areas	86
Skilled labourer, urban areas	116
Skilled labourer, rural areas	109

In the absence of any other data, these figures may be taken as representing the general agricultural wage level in India, there being no evidence of a decline in wages from any other part of the country.

Industrial Wages.

101. (b) Regarding the industrial labourer, the figures submitted to us are as follows:—

Wages in the Bombay cotton mills are to-day 232 against 100 in 1914. In the Jute mills and the mines of Bengal, the figures are 150 against 100 in 1914. From no province in India did we receive even any suggestion that industrial wages had a tendency to fall.

102. It is instructive to examine how increases in wages have varied with the rise in prices since 1914. The following figures show the variations in the Jute Mills in Bengal.

Jute Mills in Bengal.

Date.	Index Numbers of Wholesale Prices in Calcutta (31st July, 1914 = 100).	Wages (1913=100).
May, 1918	173	110
April, 1919	190	110†
September, 1919	200	120
January, 1920	218	140
October, 1920	206	150
April, 1925	169	150

Regarding the Cotton Mills in Bombay, we have, unfortunately, no figures showing the increases given after 1914 and before 1921, when the full increase of 131 per cent. was given. I am not sure that the beginning of the increase in the wage of the cotton mill operative was not made before 1921. As, however, no figures for 1919 and 1920 are available, I am unable to give any definite comparison.

103. The above shows that the industrial labourer either did not press effectively for full compensation for the higher cost of living, or the employer delayed recognising the hardship of his employee. This illustrates the lag in

* *Vide* Appendix 49.

† See Appendix 99. (Letter from Messrs. T. Duff & Co.).

wages, and the very slight connection, over a considerable period of time, between variations in the cost of living and in wages.

104. But once an increase is given, be it in the permanent wage of the operative, or in the shape of a bonus varying with the earnings of the industry, the operative will not reconcile himself to any reduction in it on any account. A very pertinent example of this is what happened in Bombay when the bonus given to the operative in the cotton mills, because of the exceptional prosperity of the industry in 1921, was withdrawn in 1923, when that prosperity had definitely disappeared. The bonus was not an increase in wage, but was a special payment based on the profits of the year concerned. The equity of the withdrawal of the bonus could not be understood by the operative and a prolonged strike ensued. Similarly, in 1925, when the cotton mills in Bombay found that the cost of living had declined and they could not afford, owing to the mills having to work at a loss, to pay the full increase in wages sanctioned in 1921, there was another strike which lasted for 10 weeks, and came to an end only because the Government of India suspended the Cotton Excise Duty, thereby enabling employers to effect an approximately equal reduction in the cost of production, while maintaining the increase in wages. But for this, the strike would have been more prolonged.

105. These two examples show the inability of the Indian industrial wage earner to reconcile himself to any decrease in wage, even on the ground of the appreciation of the rupee in gold. What has happened in the case of the mill operative in Bombay has not been challenged as being likely to happen in the case of wage earners in any industry in any other part of India. It has been said that the cotton-mill owners in Bombay blundered in giving such a large increase as 131 per cent. over the pre-war level of wage, and hence Bombay's anxiety to get the lower ratio of exchange. At best, this is a most uncharitable view of the Bombay millowners' attitude on this question. It is not contended that the exchange should be fixed at 1*s*. 4*d*. to help them over what some regard as an extravagant increase given by them. The increases given in other industries would be equally incapable of reduction without a bitter struggle with labour in those industries.

106. The publication by the Department of Statistics of the Government of India, styled "Prices and Wages in India," gives changes of wages in selected industries up to 1922. Unfortunately, the necessity for retrenchment in 1923 led to the discontinuance of this publication, but none of the industries dealt with in the last (37th) issue appears to have effected a reduction in wages up to that year. The various industries selected are as follows:—

Rice Mill, Rangoon.

Jute Mill, Bengal.

Tea Gardens, Assam.

Cotton Hill, Madras.

Engineering Workshop, United Provinces; (Some fall in 1922, owing to trade slump).

Cotton Mill, Cawnpore; (Bonus subsequently stopped).

Army Boot Factory, Cawnpore.

Woollen Mill in Northern India; (Wages of some Mistries reduced owing to low production, and in other cases on engagement of new hands).

Colliery, Bengal.

Paper Mill, Bengal.

We have had no figures regarding the present wages in these industries, but my private enquiries have elicited the information that no reduction has been made since 1922 in any of them.

107. It has not been suggested by any official witness that the Government either intend or would find it feasible to make any reduction in the wages of their employees on the ground of the appreciation of the rupee in relation to

gold. With regard to their employees on the State railways, the rise in the average wages of the largest classes of labour in the North Western Railway Locomotive Workshops at Lahore was as follows:—

1914 = 100.	1922. Daily.	Monthly.
Fitters	218	245
Carpenters	181	204
Unskilled labourers	194	220

Clerical Wages.

108. (*c*) An official statement issued by the Bombay Labour Office in February 1926 gives the result of an investigation held into the wages of clerical workers in the City of Bombay in 1924. The averages given for each group into which the clerical service was divided for this purpose are as follows:—

	Percentage over 1914.
Railways and allied offices	78
Semi-Government Offices	81
Banks	79
Commercial Offices (about)	70

It has not been submitted to us by any witness that the rise of the rupee from under 1*s.* 4*d.* to 1*s.* 6*d.* during the last year has brought about any reduction in the wages of these workers.

Difficulty of Adjustment in Wages.

109. This confirms the general conclusion that the wages of manual labourers and of the lower ranks of clerical workers do not undergo a reduction in India, except when there is substantial unemployment or a redundant supply. The literate and comparatively educated classes seeking employment in clerical posts can reason, and perhaps reconcile themselves to changing conditions such as increase in the purchasing power of the rupee; but the class of labour which is illiterate, and therefore less capable of reasoning, is unable to reconcile itself to any reduction of wages, under any circumstances, without a bitter struggle.

Strain on Industry.

110. Industries generally in India are still suffering from the prevailing depression. An adjustment in wages to the 1*s.* 6*d.* basis, if it has to be enforced, will therefore entail a long and bitter struggle between Labour and Capital, with consequent disturbance in the economic organisation of the country. The desirability of avoiding such a strain on industry in any country is obvious. The anxiety of the Government to avoid having to reduce wages in factories and departments under their own control should be sufficient to convince them of the risk to which industrial development will be exposed if the adjustment of wages to the higher ratio is to be enforced.

Wages and Cost of Living.

111. It was contended by Sir Basil Blackett in his evidence before us that he recommended the ratio of 1*s.* 6*d.* in order to avoid having to face a demand for higher wages. If any reliance is to be placed on the cost of living index numbers it is seen that there is a margin between the existing Indian cost of living index number of 155, in March, 1926, and the rise of wages over the pre-war level. If the cost of living in India is likely to increase on a reversion to the 1*s.* 4*d.* ratio, at the most, it cannot exceed 12½ per cent. even assuming that adjustments to 1*s.* 6*d.* have fully taken place, and the wages earned by the three classes of labour referred to above show a margin to cover this, excepting in the case of the labourer in the jute mills and mines in Bengal. On the other hand, if internal prices have not adjusted themselves

completely to the 1*s*. 6*d*. ratio, the rise in the cost of living, owing to the lower ratio of 1*s*. 4*d*. being fixed, would not be as high as 12½ per cent. But there again, owing to the absence of convincing proof, one is unable to arrive at a definite percentage of the increase involved by the adoption of a 1*s*. 4*d*. ratio.

Wages and Provincial Finance.

112. In paragraph 210 of their report, my colleagues quote from a letter submitted to us by the Madras Government, in which they deprecate any change in the currency policy "which would result in a further rise in prices, rendering a revision of salaries again necessary, which would in turn lead to the levying of additional taxation." I presume that the Government of Madras mean that these results would follow as if the ratio was fixed at a figure lower than 1*s*. 6*d*. In the first place, I may point out that no other Provincial Government has put forward any apprehensions of this kind. Even the honourable Ministers of the Madras Government have not endorsed these apprehensions, having restricted their concurrence to another aspect only of the reference made to them (*). I have dealt above with the merits of these apprehensions. If the Indian Civil Service is included in the fears expressed, it has to be borne in mind that when the Royal Commission on the Superior Services, presided over by Lord Lee, submitted their report, exchange was well below 1*s*. 4*d*. gold, and the increases given on their recommendations were certainly not based on a rate of exchange higher than 1*s*. 4*d*. gold.

Conclusion as to Wages.

113. It must, therefore, be admitted that no adjustment either in agricultural, industrial or clerical wages has taken place, and none would hereafter, without a strugle. It is clear that there has been no reduction so far from the level of wages in 1921, when the rupee was below 1*s*. 4*d*. gold.

Wages in the United Kingdom.

114. In sharp contrast to this State of things in India is the variation in the rates of wages of labour in the United Kingdom. The only wage index that I understand exists at present for the United Kingdom shows variations in the rates of wages as follows:—*

—	*Wages* (July, 1914 = 100).	Ministry of Labour *Cost of Living Index* (percentage of pre-War).
1919—January	206	220
June	210	207
December	226	225
1920—January	229	230
June	261	252
December	276	265
1921—January	277	251
June	264	219
December	223	192
1922—January	217	188
June	197	184
December	178	178
1923—January	177	177
June	176	169
December	173	177
1924—January	173	179
June	178½	170
December	179	180
1925—January	180	179
June	181	173
December	180	175
1926—January to April (inclusive).	180	173—167

* *Vide* Appendix 66.

Rates of wages of 11 classes of wage-earners, including those in sheltered and unsheltered industries, are averaged in this index. (I am indebted to Professor A. L. Bowley, D.Sc., F.B.A., of the London School of Economics for these figures.)

The adjustment of wages to various factors, including exchange, is thus more or less automatic in the United Kingdom, and for all practical purposes wages are brought into line with the cost of living.

Foreign Competition.

115. Further, until adjustment is complete, a 1*s*. 6*d*. ratio presents the foreign manufacturer with an effective though indirect bounty of 12½ per cent., which will place a heavy strain on Indian industries nascent and established, and protected industries will consequently need a further 12½ per cent. countervailing protection, or assistance by subsidies.

(iii) STABILISATION AT 1*s*. 4*d*.

116. For these reasons I am unable to accept the proposal to legalise 1*s*. 6*d*. as the new standard of money payments in India, and recommend that the rupee should be stabilised at the rate which obtained for nearly 20 years, *viz*., 1*s*. 4*d*. to the rupee.

117. It might be asked why I recommend stabilisation at 1*s*. 4*d*. and at no other rate. I do so because I share the widely-held opinion that a country's standard of value should never be changed unless circumstances arise, permanent in their effects, compelling a change; unless, in other words, it is found that the ratio is absolutely unmaintainable, or unattainable after a fall. The period during which her "permanent ratio" was unmaintainable was shared by India with almost every other country in the world, and was the sequence of a world convulsion which affected them all. The Babington-Smith Committee recommended a change in India's legal ratio under abnormal conditions. Its recommendation was put into force when no other country had undertaken the settlement of its monetary problems. Had the 2*s*. ratio not been put on the Statute under the conditions of 1920, and had the 1*s*. 4*d*. ratio been left undisturbed when the fall in world prices took place, I am convinced that the probability is that it would have been naturally reached once more. The fall under 1*s*. 4*d*. would have been temporary, and the rate would have found its natural level again under the conditions of 1923 and 1924 at the latest, as, in fact, it actually did. With a ratio of 1*s*. 4*d*. on the Statute, there would have been no possibility of the pre-war parity being exceeded, as gold would have flowed in at that point. I am anxious that the country should now at least be freed from the effects of the error of judgment of 1919-20, and of the artificial measures taken subsequently as its corollary.

118. Advocating, as I do, stabilisation at 1*s*. 4*d*., on this fundamental consideration, I need hardly say that I cannot agree with those who protest that, in doing so, I am advocating a depreciation of the Indian currency. In fact, I urge that the artificial appreciation of the Rupee, represented by the 1*s*. 6*d*. rate, justified neither by India's circumstances nor by her requirements, should be eliminated and should in no way prejudice considerations determining her legal ratio.

(1) EFFECT ON THE FINANCE OF THE CENTRAL GOVERNMENT.

119. It is claimed that the loss involved to the Government of India Budget by stabilisation at 1*s*. 4*d*. as against 1*s*. 6*d*. will be as follows:—

(1) Revenue (in rupees):
  (1) General Budget: 3·16 crores.
  (2) Railway Budget: 1·01 crores.
(2) Capital Expenditure:
  Railways: 1·68 crores.
  Postal and Telegraph: 2½ lacs.
  New Delhi: Rs. 63,000.

I cannot but regard the remarks made by Mr. McWatters in the first part of paragraph 4 of his Note under "Stabilisation of Exchange," as exaggerated. The Railway Budget is separated from the General Budget for purposes of taxation, and would not count, except to the extent of the division of surplus profits between the Railway Reserve Fund and the General Budget. The most serious item to be considered is the alleged gain from 1*s*. 6*d*. of Rupees 3·16 crores in the General Budget. As against this, there is to be put an increase of 2·62 crores in Customs on stabilisation at 1*s*. 4*d*.* After allowing for a margin of 62 lacs in respect of the two assumptions made in that statement, there would remain only rupees 1·16 crores to fill the gap in the General Budget.

120. This does not take into account the decrease under bounties to certain industries gievn on the rise of exchange to 1*s*. 6*d*., and an increase in receipts under Income Tax and Corporation Tax, owing to industries being spared the disturbance incidental to 1*s*. 6*d*., bearing in mind in this connection that Joint Stock Companies in India pay very nearly 15 per cent. out of their profits under Income Tax and Corporation Tax. Furthermore, there has to be considered the general improvement in trade and agricultural prosperity, and the consequent increase in imports resulting in additional benefit to the Exchequer. It is suggested that there may be a lag in the receipt of increased revenue under Income Tax and Customs Duties. It is not clear why this lag should be for more than a few weeks, because the change in the ratio would automatically involve a corresponding change in rupee calculations for purposes of Customs Duties and Tariff valuation.

121. But the very fact that Sir Basil Blackett looks upon the increased revenue, accruing from a 1*s*. 6*d*. rate, as a tangible revenue, worth even naming for purposes of discussion of the ratio, shows that he is not convinced that adjustment to a 1*s*. 6*d*. rate is complete. Giving evidence before us in Calcutta, he said that after a number of years it made no difference to the Government what the rate of Exchange was. (Question 10,451.) He did not indicate what period he had in mind when he said this, but one may presume that he meant the period of non-adjustment. As long, therefore, as the adjustment is incomplete, this unearned increment in the Government of India Revenue Budget will be a tangible and visible asset, for it is clear that this gain from Exchange exists during the period of non-adjustment only, and will vanish when adjustment is complete. In the former case, the plea that the *de facto* rate, if changed to a lower rate, would cause serious economic disturbance, does not stand. In the latter case, the gain to the Exchequer, besides being not a "decisive factor," is not a practical issue deserving consideration. The Government has, therefore, to admit that this argument for stabilisation at 1*s*. 6*d*. has no value. Moreover, during the period of non-adjustment, while there is a tangible gain to the Exchequer, some one pays for it. In the words of Mr. Robert Campbell and Sir John Muir, in their supplementary note in the Fowler Committee Report, "This advantage is not obtained without being paid for, and the question of who pays for it is not difficult to answer; it is the producer who has to accept so many fewer rupees for the produce he has to sell."

(2) Effect on Contracts.

122. It has been urged that a change to 1*s*. 4*d*. will prejudicially affect outstanding contracts of a short term character. On the other hand, it has been suggested that stabilisation at 1*s*. 6*d*. will similarly affect the bulk of other outstanding contracts, particularly the indebtedness of the agriculturist to the moneylender, which is the largest amount involved in this consideration. The outstanding contracts can be divided as follows:—

(1) Contracts of a commercial nature, such as contracts to buy and sell goods, ordinarily liable to liquidation within a period of six to twelve months.

(2) Contracts to borrow on behalf of commercial and industrial concerns, which have a currency of 20 to 30 years, such as Debentures of Joint Stock companies.

* *See* Appendix 96. Mr. McWatters' further Statement.

(3) *Contracts entered into by the agriculturist of India, who is notorious* for his continuous borrowing from father to son, borrowing which, unfortunately, is rarely repaid, and where both the lender and the borrower are happy if interest only is regularly paid either monthly or yearly as the arrangement may be.

Commercial Contracts.

123. Regarding (1), it is asknowledged that for all commercial transactions, exchange can be covered for a period of 12 months ahead. If therefore the importer in India elected at any time to keep his exchange open against some contracts to buy for delivery within the following 12 months, one need hardly consider his case. Such a person elected to speculate in exchange, and if he suffers, the fault cannot be anybody else's but his own. Further, it has been widely known all over India since July 1924 that the existing statutory rate of 2*s.* to the rupee had to be changed for a more effective ratio, and no ordinarily careful person would have been justified in leaving his contracts open, or entering into contracts where he could not have covered his exchange.

124. Speaking in the Assembly on the 1st of March 1921, Sir Malcolm Hailey, then Finance Minister, explaining that the Government were not responsible for the losses of those who had traded, counting on the 2*s.* ratio being maintained, said:—

> "But I would ask the House to remember that I definitely told the Legislative Council last year that it was impossible to say what variations might take place in the rupee-sterling exchange throughout the year. Ordinary commercial prudence should have led merchants to cover their exchange."

125. If the Government of India had justification for what Sir Malcolm Hailey said in 1921 with reference to a rate which was put on the Statute Book, and to maintain which the Government spent such a colossal amount of India's reserves, there is hardly anything to be said for a rate which is neither statutory nor has the weight of official indication*; for, indeed, if there was an impression that the Government wanted 1*s.* 6*d.* it was known that the Indian public were against changing the permanent ratio of India unless convincing proofs could be adduced.

Industrial and Commercial Borrowings.

126. The industrial and commercial corporations borrowing over a period of 20 or 30 years would not be prejudicially affected by having to meet their obligations at the gold value of the rupee at 1*s.* 4*d.* if they entered into their obligations before 1917. It is only those who have had to borrow since 1917 who would be affected by the ratio of 1*s.* 4*d.* No figures are available as to the numbers or amounts thus involved, but in any case they cannot be very large. It must be admitted that those who borrowed when Exchange was unpegged and fluctuated between 1*s.* 4*d.* and 2*s.* 10½*d.* and from there down to 1*s.* 3½*d.* to the 1*s.* 6*d.* of to-day, would sustain some unforeseen loss, or profit, according to their operations. But the Government resisted any claim from the commercial community affected by their inability to maintain the ratio at 2*s.*; and the losses of persons adversely affected by a revision to the ratio best suited to the country's requirements would only be met by them with an expression of sympathy for the misfortunes of such people, and nothing more. These fluctuations perhaps were unavoidable up to a certain point during the aftermath of the War, and the best that can be done by us is to decide as to who would be most injuriously affected by the ratio recommended, and whether they can be saved from its effects.

* *Vide* Sir Basil Blackett's answers in the Assembly, 19th September, 1924, Vol. IV: No. 56, page 3812.

The Agricultural Indebtedness.

127. Looked at from this point of view, the indebtedness of the Indian agriculturist and the masses demands serious consideration. Mr. M. L. Darling, I.C.S., of the Punjab, estimates that the indebtedness of this class, including even the prosperous canal agriculturist in the Punjab, is over 600 crores of rupees.* It is probably another 200 crores on the Indian States. As the rate of Exchange between 1900 and 1917 was around about 1*s.* 4*d.*, it is only right to assume that most of this debt of 800 crores was contracted when the rupee was 1*s.* 4*d.* gold. Now to put on the statute book 1*s.* 6*d.* gold would practically mean putting a burden of 12½ per cent. on these borrowers, and this is a class whose contracts ought to come in for full consideration in any decision to stabilise the rupee. Under the heading of Contracts, therefore, the higher figure of 1*s.* 6*d.* has little to recommend it, and very much against it.

(3) STABILITY OF A 1*s.* 6*d.* RATIO.

128. Another important consideration is whether the 1*s.* 6*d.* ratio is as easy to maintain as 1*s.* 4*d.* Officials of the Government of India have all maintained that in their opinion Government have the resources to maintain exchange at 1*s.* 6*d.* Mr. Kisch of the India Office, giving evidence, agreed in this, and several retired officials of the Government of India have supported this view. On the other hand, the Indian Section of the London Chamber of Commerce have pointed out that India has had during the last five years successively prosperous monsoons, and it must not be overlooked that India is liable to bad monsoons at intervals, and has had experience in the past of two and even three consecutive bad monsoons. Under such circumstances, the question of the possibility of maintaining the rupee at the higher ratio of 1*s.* 6*d.* is a matter of serious consideration. But even granting that the Government of India have at the moment resources enough to support Exchange at 1*s.* 6*d.*, the question we have to decide is whether it is necessary to fix a ratio that would require larger resources to maintain, if the fixing of such a higher ratio can be avoided. None can say that the Government of India would not require larger reserves to maintain Exchange at 1*s.* 6*d.* than at 1*s.* 4*d.*; in fact, a little lull in the export trade from March, 1926, necessitated resort to deflation in India to the extent of rupees 8 crores to maintain Exchange, and following the first deflation of 3 crores, an announcement that the Government would sell Reverse Councils at 1*s.* 5¾*d.* The very fact that a slight lull in the export trade necessitated this support, shows that 1*s.* 6*d.* cannot be looked upon as so easy to maintain as 1*s.* 4*d.* has proved to be between 1899 and 1914. Even granting that in the first year of an unfavourable balance of trade, the Government can maintain 1*s.* 6*d.* by selling Reverse Councils, should such a risk not be minimised, by adopting the lower ratio of 1*s.* 4*d.* which necessitated administrative support by sale of Reverse Councils only during two periods of extraordinary occurrence, not in India, but abroad?

129. The occasions when Reverse Councils had to be sold, between 1899 and 1924, are as under:—

	£
In 1907-1908-1909, total sales of Reverses	8,058,000
In 1909-1910, total sales of Reverses	156,000
In 1914-15, total sales of Reverses	8,707,000
In 1915-16, total sales of Reverses	4,898,000
In 1918-19, total sales of Reverses	5,315,000
In 1919-20 and 1900-21, total sales of Reserves . . .	55,532,000

* Page 17, "*The Punjab Peasant in Prosperity and Debt.*"

It is clear that the 1907 to 1910 sales were due to the American crisis, and the 1914 to 1921 to the effects and the sequence of the War, and mismanagement of Indian Currency on the Babington-Smith Committee's majority recommendations. Therefore they were not Indian conditions which disturbed the statutory ratio of 1*s.* 4*d.*, but external forces over which India had no control, and which could not have been foreseen or avoided. In the present case it is difficult, if not impossible, to ascertain to what extent the risk to which the freaks of nature in Indian climatology and an unfavourable balance of trade would expose the resources of the Government of India to the point of depletion. Why take any risk in this connection if it can be avoided? I consider that by fixing the ratio at 1*s.* 4*d.* this very substantial risk, which, if not perceptible at the moment, is certainly not fanciful, can and should be appreciably diminished.

(4) Melting Point of the Rupee.

130. It has been contended that with a 1*s.* 6*d.* ratio the melting point of the rupee will be at a higher figure (48*d.*) than with 1*s.* 4*d.* (43*d.*), and that this constitutes an advantage on the side of the 1*s.* 6*d.* rate. But we recommend the issue of one rupee notes, convertible only into legal tender money and gold, and not into silver rupees, as a precaution against a rise in silver prices. The evidence of the American witnesses in this connection is illuminating, and indicates that inasmuch as silver is now mined mainly as a by-product of various ores, the anxiety of silver holders should be rather to sell it at or near the present price of 30*d.* than to expect a rise. But should circumstances change in the future, Professor Sprague put it well when he said that if silver rose to or over 48*d.*, there would be nothing to prevent it from going to 56*d.* or 66*d.* The melting point of the rupee as expressed in the price of bar silver therefore ceases to be a consideration in deciding between a ratio of 1*s.* 6*d.* or 1*s.* 4*d.*

(5) Currency Reserves.

131. A revaluation of the Reserves consequent upon the adoption of a ratio of 1*s.* 4*d.* would make the position of the Central Bank easier, since the *ad hoc* securities in the Paper Currency Reserve would be reduced to the extent of about Rs. 14 crores. It will be seen from Paragraph 136 that my colleagues have recommended that about Rs. 57 crores of created securities now in the Reserve should be converted during the course of the next ten years into marketable securities. The valuation of these securities at 1*s.* 4*d.* instead of 1*s.* 6*d.* would reduce by 14 crores the amount of securities thus to be replaced and *pro tanto* relieve the Government of the necessity of borrowing in the open market.

(6) Other Arguments for 1*s.* 6*d.* Examined.

Adjustments and the course of foreign trade.

132. It is claimed by my colleagues (para. 190) that if adjustments to the 1*s.* 6*d.* rate had not taken place, such non-adjustment would be reflected in the foreign trade of India, and either exports or imports would be subjected to a handicap. But, they say, " the general trade of the country, taken as a whole, shows no signs of the imposition of such a handicap."

133. My colleagues admit that India has had four good years in succession. Bearing in mind the low holding power of the grower in India, it is no proof of the suitability of the existing rate of exchange that exports have continued, and have not shown a falling off since the higher rate has been in operation. The bulk of Indian exports consists of raw materials. If the crops are grown,

they have to be sold before the next harvest, and this must be done whatever the rate, as long as there is any demand for them in the world markets.

134. My colleagues from India will not overlook the constant complaint that has prevailed there since 1922-23, that trade generally has been slack, especially the import trade. In spite of four good years and lower prices for imports, the Indian consumer has kept out of the market for imported articles beyond his imperative requirements. Even in Lancashire I understand that the feeling has lately been gathering that non-adjustment to a higher Indian exchange brings in its train a reduction in the purchasing power of the Indian masses.

135. My own conclusion is that no such inference as my colleagues draw from the course of India's foreign trade is warranted. If anything, the continued slack demand for imports is to be regarded as an indication of the lower purchasing power of the masses, due to non-adjustment to the 1*s.* 6*d.* rate.

Absorption of gold.

136. In Paragraph 203, my colleagues refer to the argument advanced by some witnesses that the higher rupee price of gold at 1*s.* 4*d.* as compared with 1*s.* 6*d.* would check the absorption of gold by India for social or alleged hoarding purposes. They point out that when adjustments to 1*s.* 6*d.* are complete, the real cost of a *tola* of gold, sold at Rs. 21-3-10, will be as great as with 1*s.* 4*d.* at which its price would be about Rs. 24-8-0. They therefore admit that till adjustments are complete the rupee cost of gold would be lower relatively to other commodities, and gold would therefore be more attractive to buyers in India. It is not, however, a question of lowering the exchange rate to check the absorption of gold for the next few years, but of the desirability of not raising the exchange rate from the level which, on other and vital considerations, has proved suitable to Indian conditions.

Alleged effects of a reversion to 1s. 4d.

137. In Paragraph 206, my colleagues apprehend a profound disturbance in economic conditions throughout India by restoring the pre-war ratio of 1*s.* 4*d.* This is an apprehension which must be fully examined. The feared rise in prices of exportable raw materials cannot be looked upon as a direct hardship to any one in India. A rise in rupee prices of imported articles may be a source of anxiety to those who manufacture for import into India. But even these manufacturers now realise that a higher rupee price would be made up for by the better purchasing power of India as a whole. The extent to which the 1*s.* 4*d.* ratio will entail a rise in prices of articles grown and consumed in India is the vital consideration in this argument of my colleagues. They apprehend a rise in the price of these articles to the full extent of 12½ per cent. because they conclude that internal prices are "substantially" adjusted to the 1*s.* 6*d.* rate. For reasons already stated, I do not accept this conclusion. I have shown that the index numbers used by them lead instead to the conclusion that adjustment to 1*s.* 6*d.* is far from complete and that the major part of it is still to come. I therefore conclude that such disturbance as may ensue from the fixation of the lower ratio will produce a very insignificant disturbance in economic conditions, injurious to but a few, if any at all. On the other hand, insistence on stabilisation at 1*s.* 6*d.* will not only produce, but will prolong, the profound disturbance of economic conditions throughout India, which is just beginning to be perceived, and the worst effects of which are still to come.

138. My colleagues apprehend that the lower ratio would severely hit consumers generally and the poorer paid members of the literate classes. If 73 per cent. of the people of India subsist on agriculture, it is difficult to

understand the concentration of my colleagues on the interests of the other 21 per cent. who live on the production of this class. I am convinced that the adjustment to 1s. 6*d*. can at best be regarded as having just started. The official figures referred to in Paragraph 108 above show that the wages of the clerical classes are not on the border line of the present cost of living and the apprehension of my colleagues is, if I may say so, an exaggerated one.

139. Regarding their plea in the interests of labour, I expected that after the experience of labour troubles in Europe lately, they would have hesitated to put this apprehension of theirs in the way they have done. It may be that with the fixation of the 1*s*. 4*d*. rate some industries may have to raise their wages if they are compelled to give their labour an increase corresponding to the index number of the cost of living.

140. But most of the industries in India, including agriculture, have been paying, since 1921, a wage which is proportionately higher now than the increase in the cost of living. A reduction in wages in India is, as said previously, not possible without serious conflict between the employer and the employee. Unless this conflict is to be forced on India, and agriculture made less attractive than it has been hitherto, the argument advanced by my colleagues cannot be accepted.

141. To my mind, in the conditions prevalent in India, both equity and expediency dictate that the monetary ratio most suitable to Indian conditions should be restored as the permanent ratio. Any partial consideration of the problem cannot but prejudice; but statesmanship requires fullest consideration of all aspects of the issues involved in this subject, and demands, in the words of the Finance Member of the Government of India, that the ratio be fixed " at whatever figure may be most truly in the interests, not of this or that section, not of the producer or the consumer or the taxpayer, considered in isolation, but in the best interests of India as a whole."* As far as labour is concerned, there should not be the least doubt that the correct view is to ensure continuity of employment and the least possible disturbance to the legitimate interests of those who employ it.

142. In the latter part of their Paragraph 206, my colleagues refer to the inconvenience that would be caused to those who deal in the Exchange Market. This, to a certain extent, would be inevitable, if the arbitrary decision of the Executive is not endorsed on the several important grounds that I have already dealt with.

143. Once the importance of the issues involved is fully realised, it can safely be said that the responsibility for such disturbance as is now inevitable must lie with the Government of India who chose to go past the pre-war ratio, and made every effort to put India on to a ratio unsuitable to her as a permanent one.

(7) Sanctity of a Ratio once Established.

144. Finally, there is the sanctity of the standard of money payments. The Fowler Committee's recommendations in regard to the standard and the ratio are perfectly clear. That ratio was set down on the Statute Book even if their recommendations in regard to the standard or the Reserves were departed from in practice. Since 1893 the rupee has always been a token coin, representing by law till 1920 7·53344 grains of gold. That the rupee has been, and is, a token coin, is admitted, both by the Chamberlain Commission and by the present Finance Member, the standard unit till 1920 being 7·53344 grains of gold. All values have been measured in terms of that standard. An attempt was made in 1920 to change that standard to 11·30016 grains of gold.

* Para. 46. Budget Speech of the Finance Member, Government of India, February 28, 1925.

and although this was legalised, for all practical purposes it has never prevailed.

145. A standard being what it is, to measure weights or lengths or values with, it stands to reason that, once laid down by law, it cannot be lightly changed. As any change in the standard of weight or length would constitute an injustice, so would any change in the standard of value. The British sovereign, as the standard unit value of the country, must always contain 113 grains of gold. Any reduction or increase of this gold content would constitute an injustice on debtors and creditors.

146. It is different with a token coin. Any debasement of the shilling, for instance, by making it smaller or of a lesser silver content, would not affect anyone; 20*s*. would represent the sovereign. The rupee is a token coin, and its intrinsic value does not matter, but it cannot pass for more or less than 7·53344 grains of gold without constituting a currency fraud. The giver of a promissory note of 100 rupees bound himself to give 753 grains of gold. Any enactment laying down a higher gold value for the rupee would oblige him to give more gold than he undertook to pay, and than the holder was entitled to receive. Herein lies the injustice of a change in the ratio.

Conclusion as to the Ratio.

Claim of the debtor class.

147. A change to 1*s*. 6*d*. hits the large bulk of the debtor class, to the benefit of the creditor class. I cannot conceive of any valid or moral reasons for a step calculated to give the latter an unearned increment at the expense of the former. In India, perhaps more than anywhere else, the debtor class is the largest and the neediest, for whom the Government has always evinced concern and solicitude. What unavoidable reason, then, is there to hit *this* class? Throughout the course of our enquiries I have not heard of a single argument, which I can reasonably accept as sound, even pointing to the inevitability, to say nothing of the justifiability, of imposing an additional burden on a class already overburdened.

Suitability of 1s. 4d.

148. A ratio moreover that stood for 20 years even during the American crisis, till 1917, and was only disturbed as a result of the War, in common with the ratios of other countries in the world, cannot lightly be said to be a ratio that is unnatural to the Indian currency system. No change is therefore called for simply because for the last ten months the Government of India have managed by artificial measures to keep the value of the rupee round about 1*s*. 6*d*., in accordance with a preconceived policy. In brief, exchange has never been allowed in recent years to find its own natural level; it has been regulated by the series of operations which I have already dealt with.

Danger of tampering with the standard.

149. There is another aspect of the matter that one cannot afford to ignore. Any tampering with the standard of value is bound to have serious political effects in India, and to cause distrust in its currency system and the financial administration of the country. A change in the standard is bound to shake the confidence of the people, who will feel that they have been wronged by it, that it has been lightly changed, and that it may lightly be changed again, for if a long established rate (I shall not call 1*s*. 4*d*. the legal rate after the enactment of 1920) is deliberately changed, what is there to prevent another change being made again at any time in the future? Can the public rightly be led to believe that any contracts that they may make on the ratio now recommended by my colleagues will not be subjected in future years to

yet another change? Herein will arise the distrust of the people, not only in their own currency and financial system, but in their Government. Indeed, the political consequences of a change in the ratio cannot be contemplated without the most serious misgivings. Why invite such consequences and such mistrust when the " permanent rate " is still within reach, and that too with very slight disturbance, if any, to existing conditions? No other country has adopted a rate of exchange higher than its pre-war rate. Even Great Britain did not change her standard when the £ sterling dropped to 3·38. Nothing would have been easier than to have then enacted that the £ sterling should represent 15*s.* instead of 20*s.*; but it was a question of Britain's credit in the eyes of the rest of the world, and the question of the equity of the contracts based on the continued existence of the sovereign containing no more and no less than 113 grains of gold. Why should India be asked to appreciate her ratio when no other country, even in the most prosperous circumstances, has considered it just or advisable, or even expedient to do so?

The " permanent rate."

150. The Fowler Committee definitely recommended 1*s.* 4*d.* as the " permanent rate," and a permanent rate should only be changed under absolute and unavoidable necessity. Other countries have made great sacrifices to return to their pre-war ratios, which is a proof of the sanctity attaching to them. But in India it is not a question of making a great sacrifice to regain her " permanent rate." It is, at worst, a question of balancing the disturbance which may be caused by a reversion to 1*s.* 4*d.*, and an adoption of 1*s.* 6*d.* Even if it is granted that the disturbance involved in the former would be as great as the disturbance still to come with an adoption of a 1*s.* 6*d.* ratio—which is the utmost that could be conceded—then the balance must be weighed, for the reasons stated above, in favour of the 1*s.* 4*d.* ratio as being the " permanent rate " established on the authority of the Fowler Committee.

Vital importance of the ratio.

151. I look upon the question of the ratio in this Report as being no less important than the question of the standard to be adopted for the Indian Currency System. I am convinced that if the absolute necessity of the free inflow of gold, which I have emphasised, is recognised, and steps taken to ensure it, the gold bullion standard proposed will be the correct one, and the likelihood of its breaking down under the strain of any convulsions in the future will be as remote as it can reasonably be. But I have very grave apprehensions that if the recommendation of my colleagues to stabilise the rupee at 1*s.* 6*d.* is accepted and acted upon, India will be faced during the next few years with a disturbance in her economic organisation, the magnitude of which is difficult to estimate, but the consequences of which may not only hamper her economic development, but may even prove disastrous. Such a disturbance and its consequences my colleagues do not foresee to-day. But the possibility of their occurring cannot be ignored. Until adjustment is complete, agriculture threatens to become unattractive and less remunerative than it is to-day, and industries will have to undergo a painful process of adjustment, unnatural, unwarranted and avoidable—an adjustment which will be much to their cost, and affect not only their stability and their progress, but in certain cases, their very existence. And should Nature have in store for India a couple of lean years after the four good harvests that we have had, during the period of forced adjustment to a rate of 1*s.* 6*d.*, the steps that the Currency Authority will have to take to maintain exchange at this rate may deplete the gold resources of the country to an extent that may seriously shake the confidence of her people in the currency system recommended.

Why take any risk?

152. With extraordinary good luck the country may find it possible to avoid all these dangers. But why incur the risk at all? Why gamble on uncertain factors if India's natural ratio of 1*s*. 4*d*., that stood for 20 years unshaken by the crisis of 1907-1908, and shaken only after 1917 by a world convulsion, and then, too, mainly because of the embargo on the import of gold, is still within India's reach?

Unparalleled Procedure.

153. The facts and figures that I have stated, and the records from which I have quoted, conclusively show that the Executive had made up their minds to work up to a 1*s*. 6*d*. ratio long before this Commission was appointed to examine the question. Indeed, they have presented to us the issue in this regard as a "*fait accompli*," achieved by them, not having hesitated by manipulation to keep up the rate even while we were in Session. I cannot conceive of any parallel to such a procedure in any country.

PURSHOTAMDAS THAKURDAS.

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