THE PRESENT PROBLEM IN INDIAN CURRENCY-I

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2 Shillings *Versus* 1s. 4d. *Ratio*

The Great European War was the most abnormal event within living memory. During its disastrous course it touched nothing which it did not upset But of all the things it touched none received a more violent shock than did the currency system that today one finds that the German mark, the Austrian crown, the Russian rouble, the French franc and the Italian lira, to mention only a few of the world's chief units of account, have lost their moorings and travelled far and wide from their original parity. Even the British pound succumbed and the rupee which was never in the thick of the war escaped the fasteners contrived by its guardian to keep it steady.

In the course of reconstruction which has followed the close of the War it is natural to find people desirous of a return to the pre-war conditions of currency. In sympathy with this universal demand there has arisen to India a party with a definite program in that behalf. In the opinion of this party Indian currency should be stabilised at the ratio of 1s. 4d. to the rupee which was the pre-war ratio of Indian currency. To this demand the Government of India seems to be opposed, not because that ratio is not good but because in its opinion it is not better. It wants or rather aims at having a 2 shilling ratio for the Indian currency. As every one is aware many Governments in Europe, apart from the wisdom of doing so, would indeed be thankful if they could only restore their currencies to their pre-war ratios—so far are they away from them. Indian currency on the other hand has already reached its pre-war ratio: In view of this the attitude of the Government of India in not being satisfied with a return to the pre-war conditions seems to be that of a naughty child always asking for more.

It is this controversy that I wish to make the subject matter of this paper. At the outset it is necessary to realise that this controversy involves two distinct questions : (i) Should we stabilise our exchange and (ii) What should be the ratio at which we should stabilise? These two questions are distinct questions. But when one reads what the two parties have to say one sees that neither the Government nor its opponents have made it clear whether their aim is to alter the worth of our unit of account, i.e. to put a new value on it or to stabilise it at its existing value. I am afraid there can be very little advance in the direction of rehabilitation of our currency until these two questions are completely separated. For, not only is the aim of altering the worth of a currency distinct from that of stabilising true that those who want to alter the worth of the currency wish in the end to stabilise it when the worth desired is attained.

But so far as the transit period is concerned, to say that we are stabilising the currency when we are altering its worth is to create confusion. For, the latter involves a deliberate policy of changing the ratio while the former means a deliberate policy of keeping it steady.

Before I enter upon the discussion of these two distinct questions it is, I think, necessary to make sure that we understand exactly how an exchange ratio is determined. For unless we grasp this, we can never intelligently follow the bearings and implications of the two questions that arise out of this controversy. To put it simply, an exchange ratio between two currencies or units of account means the value of one in terms of the other. Now, a unit of account is value in terms of another unit of account not for its own sake, unless it is wanted as a curio, but for what it will buy so that we can say, for the purpose of introducing the subject in a concrete form, that Englishmen will value Indian rupees in as much as and in so far as those rupees will buy Indian goods. On the other hand, Indians will value English pounds in as much as and in so far as those pounds will buy English goods. It, therefore, follows that if rupees in India rise in purchasing power or remain stationary or rise less rapidly while pounds in England fall in purchasing power (i.e. if the Indian price level falls relatively to the English price level) fewer rupees would be worth as much as a pound. In other words when rupee prices in India will fall the exchange value of the rupee in terms of the pound will rise. Contrariwise if rupees in India fall in purchasing power while pounds in England rise in purchasing power or remain stationary or fall less rapidly (i.e. if the Indian price level rises relatively to the English price level) fewer pounds would be worth as much a rupee. In other words, when rupee prices in India will rise the exchange value of the rupee will fall. From this we can lay down as a general proposition that the exchange ratio of two units of account is on a par with the exchange ratio of their purchasing powers. This is in short the doctrine of Purchasing Power Parity as an explanation of a particular exchange ratio between two currencies or units of account. I insist upon a firm grasp of this doctrine because I find some of our leading lights seem to hold that a particular exchange ratio is the result of the balance of trade. This view is somewhat difficult to understand. For as a matter of fact, in international trade, wherein exports pay for imports, there is never such a thing left as an unpaid balance. It is true that a part of the trade dues are paid for by money ; but there is no reason why the part liquidated by money should be spoken of as a balance. All that it means is that money enters into international trade just as other commodities do. There is nothing peculiar about money in that. Nor is there anything peculiar in the variation in the extent to which money enters into international transactions. The extent to which money enters into trading transactions of a country is governed by the same law of relative value as is the case with any other commodity. The commodity which is relatively the cheapest tends most to go out of the country. At one time it may be cutlery and at another it may be oranges and at a third time it may be money. If no one speaks, as one may very well do, of a balance of trade in terms of cutlery or oranges when after a stage of normal equilibrium more of them go out of the country than they did before, there is neither rhyme nor reason in speaking of a balance of trade in terms of money when after a stage of normal equilibrium more money goes out of the country than it did before. This usage is, however, pardonable as being a harmless survival of the mercantilist days. But what is grossly absurd and foolish is the view that the exchange ratio of a unit of account is determined not by its purchasing power but by the balance of trade. This view is a pure inversion of cause and effect. It is true that a fall in the exchange value is accompanied by an adverse balance of trade and a rise in the exchange value by a favourable balance of trade. But an adverse balance of trade in the sense that commodity exports are falling off while commodity imports are rising evidently means that the particular country has become a market which is good to sell in but bad to buy from. Similarly, a favourable balance of trade in the sense that commodity exports are rising while commodity imports are falling off evidently means that the particular country has become a market which is good to buy from but bad to sell in. Now a market is good to sell in but bad to buy from (typified by the case of a fall in the exchange value accompanied by an adverse balance of trade) when the level or prices ruling in that market is higher than the level of prices ruling outside it. in the same way a market is good to buy from but bad to sell in (typified by the case of a rise in the exchange value accompanied by a favourable balance of trade) when the level of prices ruling in that market is lower than the level of prices ruling outside. This simply is another way of stating that lower prices means a high exchange value and a favourable balance of trade and that higher prices mean low exchange value and adverse balance of trade. The balance of trade is thus the result of the changes in the exchange value and not vice versa, and exchanges in the exchange value are the result of changes in the price level, i.e. changes in the purchasing power of units of account. This is the most fundamental fact and although some might resent the digression as feeding the baby I think it was necessary. For many people talk hopeless nonsense about stabilisation of exchange and fixing the exchange at choice ratios as though it had nothing to do with the question of prices. On the other hand changes in exchange are ultimately changes in the price level and as much have profound bearing upon the economic welfare of the people. Remembering then that regulating exchange is the same thing as regulating the purchasing power of the currency, we may proceed to discuss the two questions that arise out of this controversy.

Firstly, should we stabilise the exchange value of our unit of account? As I have said above, foreign exchanges compare in value of the currency of one country with that of others. It follows that exchange values of two currencies are important only to merchants who do not buy and sell in the same country. Again, it is of no consequence to them what the exchange value is, i.e. whether the rupee is worth 1s. or 2s. provided the figure is always the same and is known in advance. It is only changes or fluctuations in the given exchange value that is of any moment to the merchant. What he wants is this invariability of exchange; to ensure this invariability is the problem of stabilisation. Under the present circumstances can we guarantee this invariability of exchange ratio to our merchants? To answer this question we must recall the basic conception of the purchasing power parity as an explanation of the exchange ratio. From that doctrine it is clear that if you want to stabilise exchange you must control the purchasing powers of the two currencies concerned so that their movements will be alike in depth as well as in direction. To stabilise exchange we must have therefore some controlling instrument which would act as a common regulator bringing about proportionate changes in the two currencies in the same direction. Hitherto one such good instrument had been found and that was a common gold standard. That standard has now been destroyed all over the world except in the United States. Consequently an automatic stable exchange on the basis of a gold standard is impossible for the present, except with the United States.

Hitherto one such good instrument had been found and that was a common gold standard. That standard has now been destroyed all over the world except in the United States. Consequently an automatic stable

exchange on the basis of a gold standard is impossible for the present, except with the United States. As regards countries which are on a paper basis, stabilisation of exchange can be secured only on two terms (i) Since we cannot control the currencies of other countries we must be prepared to manipulate our currency in sympathy with theirs and be ready to appreciate it when they depreciate theirs, (ii) Without manipulating the whole of our currency we should be prepared to sell and buy foreign exchange at a fixed ratio. Both these projects for securing invariability of exchange must, I think, be rejected as injurious as well as hazardous. There is no doubt that stabilisation will promote, as nothing else can, the revival of international credit and the movement of capital to where it is most required. One of the most vital parts of pre-war organisation would thereby be restored and an element of uncertainty would vanish. Markets given up as lost would be again nursed, which would give an impetus to trade and industry. But there is no doubt that the benefit to be derived will not be worth the cost involved. Our external transactions are infinitesimal as compared to our internal transactions. To dislocate our internal arrangements by constant changes in our price level to preserve external parity is too big a price for a gain which is after all paltry. For, our merchants must remember that though fixity is a great advantage, yet its absence is not an absolute bar to the carrying on of international trade. We have an instance of this in the history of our own currency. For two full decades between 1872-1892 there were the greatest oscillations in Indian currency. Then as now our merchants did clamour against the instability of exchange being an hindrance to trade. But our history shows that even under fluctuating exchange they did thrive and prosper and it may be hoped that their sons may instinctively know how to do the same. Should this fail to carry consolidation, one would recommend the movement of our price level even if it involved the management of our currency, had the Governments of the European countries not been in such an impecunious condition. As it is, by consenting to move our price level in sympathy with theirs we would be committing our welfare to the care of bankrupt governments and their desperate ministers. A currency which is managed on a basis approved by science would no doubt do the best. To be linked up with a currency which is managed solely to meet the exigencies of trade would be tolerable. But it would be an intolerable management of our currency to join hands with a partner who is living on his currency to keep himself going.