STATEMENT OF EVIDENCE TO THE ROYAL COMMISSION ON INDIAN CURRENCY

NOTE

The Royal Commission on Indian Currency and Finance visited India in 1924-25 to examine the financial system and to suggest the Reform of the Indian currency. The commission was comprised of the following members.

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Dr. Ambedkar explained his views in the statement submitted in reply to the questionnaire issued by the Commission. The statement and his evidence before the Commission are reproduced here along with the questionnaire.

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STATEMENT OF

EVIDENCEmk:@MSITStore:C:\Important\Writing_Of_Babasaheb.chm::/30. Statement of Evidence to the Royal Commission.htm - _msocom_1

Submitted by Dr. B. R. Ambedkar, Bar-at-Law to the Royal Commission on Indian Currency

1. In reply to the questionnaire issued by the Commission I beg to submit the following statement of my views. In dealing with the questionnaire issued by the Commission I will begin with question No. 4 because I believe that is the principal issue on which the Commission is asked to give a definite finding.

2. I am emphatic in my opinion that the Gold Exchange Standard cannot be continued with any advantage to India and for the following reasons:—

(1) *It has not the native stability of the Gold Standard.*— A pure Gold Standard is stable because the value of gold in circulation is so large and the new additions to the supply are so small that the stability of the standard is not thereby appreciably affected. But in the case of the Exchange Standard the new additions are dependent upon the will of the issuer and can be augmented to such an extent that the stability of the standard can be appreciably affected thereby.

(2) *It is discretionary in issue without there being anything in it to regulate the discretion.*—It is sometimes said that the Gold Standard is a hard standard which keeps the changing affairs of mankind tied to the wheel of nature over which human agency can exercise no control and that the Exchange Standard affords an escape from this frigidity. In reply to this it must be said that though a discretionary currency, it is so only when the currency is provided with some means which enables this discretion to be properly exercised. There must be some regulator by which the discretion left to the issuer is regulated. From this point of view an Exchange Standard is inferior to a Convertible Standard. A Convertible Standard and an Exchange Standard are alike in this that they both allow the use of discretion in the issue of currency. But a Convertible Standard is superior to the Exchange standard because the discretion of the issuer in the former is *regulated while* the discretion of the issuer in the latter is *unregulated.* It is true that in the Exchange Standard there is what is called regulation by foreign Exchanges. But such a regulation, though it is better than no regulation at all, is only a loose and indirect way of reaching the end and cannot be depended

upon in all circumstances of reaching it.

(3) *It is economical. But for that very reason it is insecure.*— There are many writers who are enamoured of the Exchange Standard, because it effects a certain degree of economy in the use of gold. But is the plan secure? Any plan of currency to be sound must be both economical and secure. It will do if it is not economical; but it will certainly not do if it is not secure. Now I submit that the proposition that to *economise gold as a currency is to impair its utility as a standard of value* is as simple and self-evident as the proposition that to use paper or rupee as a medium is more economical than to use gold. For what does this discarding of gold from currency use mean? It simply means this : that by economising the use of gold you thereby directly increase its supply and by increasing its supply you lower its value, i.e. gold by reason of this economy in its use becomes a depreciating commodity and, therefore, unfit to that extent to function as a standard of value. *You cannot therefore both economise gold and also use it as a standard.* If you want to economise gold, then you must abandon gold as a standard of value, in other words the economy of the Exchange Standard is incompatible with its security.

3. The choice therefore can never be between a Gold Standard and an Exchange Standard. If we do not want a Gold Standard we must either go over to a Compensating Standard of Prof. Fisher or to a Tabular Standard of Prof. Jevons. The choice is really between either of them and the Gold Standard. There is no doubt that the Compensating Standard or the Tabular Standard would be better than a Gold Standard. But mankind must become more philosophical than it is before they can be made workable, and

until that happens I think the Gold Standard must be accepted as the only system of currency which is"knave proof"and"fool proof."

4. The next important question is that of the Gold Reserve. Before discussing matters such as location, composition, etc., of the reserve, it is necessary to determine whether we want it. That question in its turn depends upon another question pertaining to the mode in which the Gold Standard is to be introduced. In this connection I do want to say that there are many people who are under the impression that the introduction of a Gold Standard means merely the starting of a mint and the issuing of a gold coin. Nothing can be more erroneous than this. Gold Standard means not the starting of a gold mint but making

provision whereby gold will *become current* For *currency is the standard*. Now in order that gold may be current, it is necessary that other forms of currency must be limited in their volume. There are two ways by which currency may be limited. One way is to make it convertible and the other is to fix a positive limit on its issue. If you choose to adopt convertibility as a method of limitation then there is reason for maintaining a gold reserve. If you choose fixity of issue as a method of limitation then there is no reason for maintaining a gold reserve. As between the two systems I prefer the fixity of issue system. My reasons are two :—

(1) One of the evils of the Exchange Standard is that it is subject to management. Now a convertible system is also a managed system. Therefore by adopting the convertible system we do not get rid of the evil of management which is really the bane of the present system. Besides a managed currency is to be altogether avoided when the management is to be in the hands of the Government. When the management is by a bank there is less chance of mismanagement. For the penalty for imprudent issue, or mismanagement is visited by disaster directly upon the property of the issuer. But the chance of mismanagement is greater when it is issued by Government because the issue of government money is authorised and conducted by men who are never under any present responsibility for private loss in case of bad judgement or mismanagement.

(2) A fixed issue system besides eliminating management will make provision for a larger use of gold in currency. The use of gold is an important matter. The whole world is suffering from a continuous rise of prices owing to the depreciation of gold. Anything therefore that will tend to appreciate gold will be to the good; and if gold is to appreciate there must be a larger use of gold as currency. Besides at the present time there is no necessity to economise gold, because there is all over the world such a great plethora of money that the less we economise gold the better. From this point of view the Exchange Standard once a boon, is now a curse. It served a useful purpose for some time. From 1873 the production of gold had fallen off and the economy effected by the Exchange Standard was indeed very welcome because it helped in a period of contraction to expand the money of the countries of the world and thereby maintain the stability of the international price system by preventing the rapid fall in prices, which would have been

inevitable if all the countries which based themselves on gold had also adopted gold as a currency. But after 1910 conditions changed and the production of gold increased, with the result that the continuance of the Exchange Standard thereafter not only did not help the countries to check the rise of prices but became a direct cause of the rise of prices. For the economy in the use of gold rendered gold which was already overproduced redundant. During the war the use of paper money on an unprecedented scale led to a still greater depreciation in the value of gold all of which was practically due to the *economy* of gold in its use as currency. Consequently as observed by Prof. Cannan"in the immediate future gold is not a commodity the use of which it is desirable either to restrict or to economise. From the closing years of last century it has been produced in quantities much too large to enable it to retain its purchasing power and thus be a stable standard of value unless it can constantly be finding existing holders willing to hold larger stocks or fresh holders to hold new stocks of it. Before the war the various central banks in Europe took off a large part of the new supplies and prevented the actual rise of general prices being anything like what it should otherwise have been, though it was serious enough."In the absence of that demand the next best thing would be the introduction of gold currency in India and the East. This introduction of a gold currency can be better accomplished by adopting the fixed issue system rather than the convertible system. For the former will leave a larger margin for the use of gold in actual currency than will the latter.

5. That being my view of the solution of the problem I am necessarily in favour of the abolition of the Gold Standard Reserve as being of no practical use for maintaining the stability of the currency. There is also another reason why I think the Gold Standard Reserve ought to be abolished. The Gold Standard Reserve is peculiar in one respect, namely this; the assets, i.e., the reserve and the liabilities, i.e., the rupees are dangerously correlated by reason of the fact that the reserve cannot increase without an increase in the rupee currency. This ominous situation arises from the fact that the reserve is built out of the profits of rupee coinage. That being its origin, it is obvious that the fund can grow only as a consequence of an *increase* in the volume of rupee coinage. Now as Prof. Cannan remarks"the percentage of administrators and legislators who understand the Gold Standard is painfully small, but it is and is likely to remain ten or twenty times as great as the percentage

which understands the Gold Exchange System. The possibility of a Gold Exchange System being perverted by ignorance or corruption is very considerably greater than the possibility of the simple standard being so perverted. Unfortunately there is abundant proof of such perversion in the history of the currency system in India. Already we have had foolish administrators who had been obsessed with the idea that a reserve was a very essential thing and who had therefore gone in issuing currency without any other consideration but that of augmenting the reserve. Nor has the country been wanting in innumerable foolish business men who have condemned the Exchange Standard without ever knowing anything of currency on the sole ground that Government is not allowing them to use the reserve as though to boom up business was the proper function of a currency reserve. Similarly we have amongst us equally foolish politicians desiring to advertise themselves as friends of the people who want the reserve to be utilised for educating the masses. Any of these three may easily bring about a calamity in the guise of a blessing, and all this in sheer ignorance of the principles of currency. It is therefore much better to introduce a currency system which will do away with the Exchange Standard and also the Gold Standard Reserve the maintenance of which may any day be a source of mischief.

6. The following then are the requirements of my plan for the reform of the Indian currency :—

(1) (1) Stop the coinage of rupees by absolutely closing the mints to the Government as they are to the public.

(2) Open a gold mint for the coinage of a suitable gold coin.

(3) Fix a ratio between the gold coin and the rupee.

(4) Rupee not to be convertible in gold and *gold not to be convertible in rupees,* but both to circulate as unlimited legal tender at the ratio fixed by law.

7. What is to become of the existing amount of reserve if it is not wanted for currency purposes? I myself would like it to be utilised by Government as ordinary revenue surplus for any public purpose that may seem to be urgent. But there will remain sources of weakness in the reformed currency which it is wise to recognise. Unlike the Fowler Committee, I am firm in my belief that the rupee currency once effectively limited will maintain its value without the necessity of any reserve. But there is just this chance that the existing volume of the rupee currency is so large that when there is a trade depression it may become redundant and may by reason of its excess lose its value. As a

safeguard against such a contingency I propose that the Government should use part of the Gold Standard Reserve for reducing the rupee currency by a substantial margin so that even in times of severe depression it may remain limited to the needs of the occasion. The second source of weakness in the currency arises from the peculiar composition of the Paper Currency Reserve. That weakness lies in the existence of what are called"Created Securities."I should like this portion of the Paper Currency Reserve extinguished as early as possible. For unless this is done the paper currency cannot with safety be made as elastic as it should be. I would therefore recommend that the remainder of the Gold Standard Reserve be utilised in the cancellation of the"Created Securities"in the Paper Currency Reserve.

8. Having given my views on the nature and form of the change I will now discuss the question next in importance, namely,"the ratio between gold and rupee."As a result of war operations there is not a single country with a Gold Standard which was able to keep its pre-war gold parity. Some of them have erred from it by such a large margin that it is now beyond the capacity of many to approach it with any degree of certainty. But howsoever impossible and impolitic the task, the hankering for a return to the pre-war parity seems to be universal. There is but this difference between India and the other countries. The other countries have yet to reach the pre-war parity. India, on the other hand, has in fact overreached the pre-war parity. As a result of the difference the problems before India and the other countries are different. In European countries the problem is one of deflating the currency, i.e., appreciating it; in other words of bringing about a fall in prices. In India the problem becomes one of inflating the currency, i.e., depreciating it; in other words of bringing about a rise in prices. For a change from 1 *s 6d.* gold to 1 *s. 4d.* gold means this and nothing else. Should the currency be inflated to reach back the pre-war parity? There are some people who are under the impression that the restoration of pre-war parity would give justice and would also give us the old price level to which we were so long accustomed. Both these views are fallacious. First : the restoration of pre-war parity is not a restoration of the pre-war price level. For it is to be remembered that 1 *s. 4d.* gold in 1925 is not the same thing as 1 *s. 4d.* gold in 1914 if measured in terms of purchasing power. The same ratio of exchange does not necessarily mean the same level of purchasing power. The ratio between two currencies may remain the same though their respective volumes have undergone enormous changes, provided the variations in volumes are equal and in

the same sense. This is exactly the result of a mere nominal restoration of the pre-war parity. If by restoring pre-war parity is meant the restoration of the pre-war level of prices then the ratio instead of being lowered from 1 *s.6d.* in the direction of 1s. *4d.* must be raised in the direction of 2s. gold. In other words instead of an inflation there must be a further deflation of the currency. Second : the restoration of pre-war parity even nominally would be unjust. As a standard of deferred payment a currency should not disturb monetary contracts. If all debts now existing had been contracted in 1914 before the war, ideal justice would clearly require the restoration of the pre-war ratio. On the other hand if all existing contracts had been entered into in 1925 justice would require us to keep to the ratio of 1925. Two things must be borne in mind in this connection. Existing contracts include those made at every stage of preceding deprecations and appreciation's and to deal fairly with all would demand that each one should be treated separately—a task impossible by reason of its complexity and enormity. Existing contracts are no doubt of various ages. But the great bulk of them are of very recent date and probably not more than one year old; so that it may be said that the centre of gravity of the total contractual obligations is always near the present. Given these two facts the best solution would be to strike an average between 1s. *4d.* and 1s. *6d.,* and to see that it is nearer 1 s. *6d.* and away from 1 s. 4d. This is substantially the view of Prof. Fisher, who observes:"The problem of a just standard of money looks forward rather than backward : *it must take its starting point from the business now current, and not from imaginary parts before the war.* One might as well talk of restoring the original silver pound or returning to the monetary standards of Greece and Rome."In short, in matters of currency the real is the normal and therefore just.

9. As regards the effects of a rising and falling rupee on trade and industry the point often sought to be made is that low exchange confers a bounty on trade and industry. But this is not the important point. The more important point is, supposing that there is a gain arising from low exchange, whence does this gain arise? It is held out by most business men that it is a gain to the *export trade* and so many people have blindly believed in it that it must be said to have become an article of faith common to all that a low exchange is a source of gain to the *nation as a whole.* Now if it is realised that low exchange means high internal prices, it will at once become clear that this gain is not a gain to the nation coming from outside, but is a gain from one class at the cost of another class in the country. Now the class that suffers is the poor labouring

class, which pays the bounty to the richer or the business class. Such a transference of wealth from the poor to the rich can never be in the general interest of the country. I am therefore strongly opposed to high prices and low exchange, and no righteous Government should be party to such clandestine picking of the pockets of the poorer classes in the country.

10. I now come to the question of providing for the seasonal needs of the money markets in India. A currency system should be stable and elastic, and it is for this reason more than any other that the currency in many countries is a compound of metal and paper. The former is intended to give steadiness and stability and the latter elasticity. Unfortunately in India the plan of the paper currency is not contrived to give it elasticity. In England under a similar paper currency the inelasticity is made good by the development of what is called deposit currency which is issued against good commercial paper. Owing to a variety of causes deposit currency has failed to take root in India and there has been consequently no mitigation of the inelasticity of the paper currency of India. We should therefore make greater provision in our paper currency reserve whereby it could be made possible to convert good commercial paper into currency best suited to the needs of seasonal demands.

COPY OF THE MEMORANDUMmk:@MSITStore:C:\Important\Writing_Of_Babasaheb.chm::/30. Statement of Evidence to the Royal Commission.htm - _msocom_2 CIRCULATED TO WITNESSES IN INDIA BY THE COMMISSION

The following memorandum, indicating the main questions which will come under the consideration of the Royal Commission on Indian Currency and Finance under its terms of reference, is published in order to assist intending witnesses in the preparation of their evidence. It is not to be regarded as exhaustive, nor is it desired that each witness should necessarily attempt to deal with all the questions raised :—

(1) Is the time ripe for a solution of the problems of Indian Currency and Exchange by measures for stabilisation of the rupee or otherwise?

What is the comparative importance of stability in internal prices and in foreign exchanges?

What are the effects of a rising and a falling rupee, and of a stable high or low rupee, on trade and industry (including agriculture) on national finance?

(2) In relation to what standard and what rate should the rupee be stabilised, if at all?

When should any decision as to stabilisation take effect?

(3) If the rate selected differs materially from the present rate, how should the transition be achieved?

(4) What measures should be adopted to maintain the rupee at the rate selected?

Should the Gold Exchange Standard system in force before the war be continued, and with what modifications, if any?

What should be the composition, sise, location, and employment of a Gold Standard Reserve?

(5) Who should be charged with the control of the note issue, and on what principles? Should control or management be transferred to the Imperial Banks of India, and, if so, what should be the general terms of the transfer?

(6) What should be the policy as to the minting of gold in India and the use of gold as currency? Should the obligation be undertaken to give gold for rupees?

(7) By what method should the remittance operations of the Government of India be conducted? Should they be managed by the Imperial Bank?

(8) Are any, and, if so, what, measures desirable to secure greater elasticity in meeting seasonal demands for currency?

Should any, and, if so, what, conditions be prescribed with regard to the issue of currency against hundis?

(9) Should any change be made in existing methods for the purchase of silver?

Note.—The above questions were circulated to witnesses in India. As the result of the oral and written evidence received in India, the relative emphasis to be laid on the various matters dealt with has become clearer, and accordingly the attached memorandum and supplementary list of"Questions to be asked by the Chairman"have been prepared for the information of witnesses.