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SOUTH ASIA INSTITUTE OF HEIDELBERG UNIVERSITY

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Reprints of publications of staff members

No. 85:

ROTHERMUND, Dietmar (Seminar für Geschichte):

An Aspect of the Monetary Policy of British Imperialism.

SD aus: The Indian Economic and Social History Review, Vol. VII, No. 1, 1970.

Reprinted from
"The Indian Economic and Social History Review"
Vol. VII, No. 1, 1970

An Aspect of the Monetary Policy of British Imperialism

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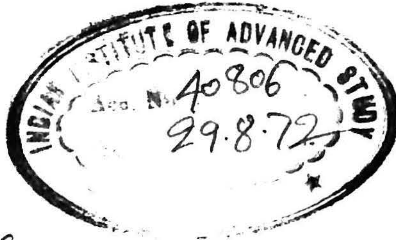

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THE MONETARY POLICY OF BRITISH IMPERIALISM*

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The administration of colonial finance and the monetary policy of the imperial powers for their dependencies made an impact on the structure of the colonial economy. This impact has not yet been studied adequately. Critics of British-Indian finance have paid attention to the "Drain of Wealth" and some economists have studied currency problems in detail[1], but they have not tried to relate monetary policy to agrarian relations, rural credit, revenue administration, the export of cash crops, and the pattern of foreign and indigenous investment. This neglect of the wider context of imperial monetary policy can be traced back to the dominant economic doctrine of the nineteenth century. According to this doctrine there was no monetary policy at all. The currency was regulated by economic forces and nobody was supposed to tamper with it; the very idea of having a monetary policy was anathema to the orthodox economists. These economists have influenced the interpretation of the events of this period. For all those who followed them it was difficult to prove that a policy existed in practice although it did not exist in theory.

The Currency Principle and Monetary Policy

The dominant doctrine of the nineteenth century with regard to money and banking was the currency principle which was based on

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*Earlier versions of this paper were read at the Fourth International Conference on Asian History, Kuala Lumpur 1968, at a staff seminar of the Gokhale Institute of Politics and Economics, Poona, and a seminar at the Delhi School of Economics. The author wishes to thank his colleagues, especially H. C. Rieger, for their criticism and suggestions, whatever errors of judgement remain in the text are, of course, entirely his own.

1. See, e.g., C. N. Vakil and S. K. Muranjan, *Currency and Prices in India*, Bombay 1927, and Sir J. C. Coyajee, *The Indian Currency System*, 1835-1926, Madras 1930.

the assumption that a currency consisting of precious metal would always establish an automatic equilibrium of all economic transactions. The advocates of this principle, following their master Ricardo, reduced everything to this metallic model. Their assumptions were challenged by economists who believed that the evolution of banking and credit did not fit into this static model; the doctrine was called the banking principle. But throughout the nineteenth century the advocates of the currency principle remained the dominant party whereas those who believed in the banking principle remained a heterodox minority whose views were appreciated only in the twentieth century, particularly in the era of Keynesian economics.[2]

In keeping with its basic assumptions the orthodox school could not admit the existence of a monetary policy, but in the late nineteenth century this school was affected by a development which led to partisan quarrels within its own ranks and forced the different parties to advocate certain policies. In the last quarter of the nineteenth century the rapid increase of the world production of silver caused a discrepancy of the gold-silver ratio which had shown a remarkable stability at a rate of about 1 : 15 over centuries. The experts debated for some time whether they were faced with an appreciation of gold or a depreciation of silver, but they were all aware of the alarming proportions of this development. Soon they split into various camps of gold or silver monometallists and of bimetallists who hoped to keep both metals in circulation by adjusting the exchange rate by means of international agreements. The debates about these issues were of a curious kind, the interests of those who produced silver and those who sold it were deeply involved, expediency was often the final arbiter of the policies adopted, but the various parties advanced arguments so as to establish the orthodoxy of their respective proposals. The flexibility of these arguments enabled the British experts to adhere to the gold standard at home and to defend the maintenance of a silver standard elsewhere, as British bankers and merchants were eager to export

2. Sir John Hicks, *Critical Essays in Monetary Theory*, Oxford University Press 1967, here especially p. 155 ff: "Monetary theory and history—an attempt at perspective".

America's new production and Europe's demonetized stock to the East.

India was the main victim of this "double standard" which was defended with such orthodox rigour. Since 1835 silver had been the only legal tender in India. The mints of Bombay, Calcutta, and Madras were open to the free coinage of silver. According to the currency principle the seigniorage was limited so as to pay only for the operating cost of the mints, it was not supposed to be used as an instrument of monetary policy which would have enabled the government to control the flow of silver. The government could, of course, close the mints but this would have been an even more radical violation of the currency principle than increasing the seigniorage. Under these circumstances the world's depreciating silver could pour into India unchecked. In 1876 the first drastic fall in the exchange alarmed the Government of India, but the home authorities did not permit any remedial measures.[3] In 1877 India absorbed about 84% of the world production of silver[4] and the exchange continued to fall. There was a conflict of interests between the home authorities and the Government of India. The revenues of India were collected in silver but the home charges had to be paid in gold. With every fall in the exchange the Government of India found it more difficult to make both ends meet. Its main sources of income—land revenue, opium, and the salt tax—were fixed and could not be enhanced easily. The Government of India, therefore, thought of various measures such as closing the mints or regulating the exchange rate by raising the seigniorage or adopting a gold standard. Even proposals for a gold-exchange standard, i.e. a standard based on gold but not necessarily implying the circulation of a gold currency, were made at that time, anticipating the proposals which were finally adopted at the end of the century. But at this early stage of the depreciation of silver none of these suggestions found favour with the home authorities.[5]

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3. Coyajee, *op. cit.*, p. 54 f.

4. Fred Atkinson, "Rupee Price in India", *Journal of the Statistical Society*, Vol. LXVI, 1903, p. 116.

5. Vakil and Muranjan, *op. cit.*, p. 78 f.

The mints remained open, on principle, and a gold standard was denied to India, not on principle, but for practical reasons. India had an important function in supporting the world price of silver and it was not permitted to cut into the scarce resources of gold. Those who defended the British approach to this problem argued that monetization in India required an adequate supply of currency, and that India would have found it difficult to expand its currency if it had adopted a gold standard.[6] But they deliberately neglected the fact that India paid a high price for this kind of expansion of its currency by absorbing a rapidly depreciating commodity. Absorbing silver was like riding a tiger—it was difficult to stop it after having started it. If India would have decided to demonetize and to sell its silver after having absorbed a major part of the world production it would have had to sell this silver at a great loss which would have been magnified by its own decision, because the price of silver would have fallen even more the moment India stopped absorbing it. British monetary experts did not mind India's ride on the silver tiger, they were even proud of this feat which was performed under their guidance,[7] but if anybody would have told them that theirs was a clever monetary policy they would have denied it and would have maintained that they simply adhered to the currency principle. A modern economist has observed that the bankers had good reasons for subscribing to the currency principle, because it provided them with a convenient shield against closer scrutiny. By claiming that their operations were regulated by the currency principle they could deny the responsibility for their actions.[8] This could also be said about the arbiters of India's monetary fate who invoked their orthodox creed whenever they were faced with suggestions for a new monetary policy for India.

In explaining the Indian case, contemporary economists gave a dialectical twist to the currency principle. Walter Bagehot set an example in writing on the depreciation of silver in 1877 and making

6. Walter Bagehot, *On the Depreciation of Silver*, London 1877.
7. Coyajee, *op. cit.*, p. 56 ff.
8. Hicks, *op. cit.*, p. 168.

a plea for keeping the Indian mints open.[9] He ardently defended India's silver monometallism, and criticized all attempts at restricting the free flow of silver to India. He adhered to the orthodox axiom that trade is nothing but an exchange of goods which cannot be affected by the rate of exchange in the long run as the automatic equilibrium will always restore itself. However, he did admit that a falling exchange constituted an export bonus and a fine on imports into India. But he reconciled this admission with the general orthodoxy of his views by pointing out that the export bonus would lead to a further flow of silver to India which would help to support the silver price and thus lead to a new equilibrium. Similar views were expressed by British delegates at international conferences which were convened so as to reach a bimetallist compromise. The British did not show any genuine interest in bimetallism but presented their own double dealing monometallism—gold for Britain, silver for India—as the ideal contribution to a better monetary world.[10]

The Expansion and Depreciation of the Indian Currency

India's mints remained open due to this stand taken by the British authorities, and the Indian currency expanded very rapidly. The total active circulation of rupees amounted to 1250 million in 1876, 1500 million five years later, and 1850 million in 1891.[11] At the same time the silver rupee depreciated by about one-third within 18 years. In 1874 the rupee stood at 1s 10d, in 1892 at 1s 2d.[12] In this way the vastly expanded currency of 1893 was worth about as much in terms of gold as that of 1876. The total stock of money at the beginning and at the end of the period could be roughly compared in terms of 2 : 3, and as the total stock depreciated by

9. Bagehot, *op. cit.*, see also the summary of Bagehot's views in [illegible] *op. cit.*, p. 53 f.

10. Vakil and Muranjan, *op. cit.*, p. [illegible]

11. Fred Atkinson, *loc. cit.*

12. Government of India, *Report of the Currency Committee*, Calcutta 1931, pp. 19, 87.

one-third its gold value remained the same.[13]

In this period the quantity theory of money had not yet been superseded by modern theories which attribute equal importance to the velocity of the circulation of money. According to the quantity theory both the growth of the population and the increase of economic transactions would justify an expansion of the currency. The advocates of non-interference, therefore, made much of the need of India's growing population for an increase in the circulation of money. But a scrutiny of the respective figures shows that the expansion of the currency was several steps ahead of the growth of population throughout this period. The population of India was 254 million in the census year 1881, the growth rate of the population was rated at about 1% per annum at that time. Ten years later the next census showed a total population of 287 million. This meant an increase of 13% in a decade which would correspond to an average increase of about 1.23% per annum.[14]

If the velocity of the circulation of the currency is assumed to be more or less the same throughout this period the increase of the currency should correspond to the growth of the population. But in India the increase of the currency outpaced the growth of the population by at least 2 : 1, because the currency expanded at the rate of about 4% per annum for the first five years after 1876 and then at about 2.3% for the following ten years whereas the population grew at the rate of 1% in the earlier period and about 1.23% in the subsequent years.[15]

It is difficult to get a precise idea of the increase of economic activity in this period, and, therefore, it cannot be estimated to what extent the expansion of the currency was justified by this increase rather than by growth of the population. If we look merely at the growth of the population we may state that the currency expanded at a rate which was about 1% higher than the

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13. The total active circulation as calculated by Atkinson (see footnote 11) was 1890 million Rupees in 1893, if reduced by 36% this would amount to about 1186 million, the total active circulation in 1876 was 1250 million.

14. See *Census of India* 1881 and *Census of India* 1891

15. For the data on the expansion of the currency, see Fred Atkinson, *loc. cit.*, 1903, S. 110-112.

rate which would have been justified by that growth. At the same time prices rose in India by about 1% per annum during the last decades of the nineteenth century.

While prices were actually rising in India there was a rapid decline of gold prices for agricultural produce in the world market. Experts praised the remarkably stable export prices of Indian produce.[16] The expansion and depreciation of the silver currency explains this "stability". If one thinks of the silver imported by India as a commodity for which it had to export agricultural produce which was frequently in great demand inside the country and if one considers that the imported commodity was subject to a rapid depreciation these "stable" export prices may appear in a different light. The fact that people had to die of famine in India when a surplus of agricultural produce caused a glut in the world market and prices fell everywhere except in India should pose a question to all those who held that the free flow of silver was of great benefit to India and could stimulate its economic growth.

Export Bonus and Indirect Protection

The contemporary Indian nationalists, for reasons of their own, also believed in the benefits of the free flow of silver. They blamed the British revenue policy for the famines and as far as the currency was concerned they echoed the orthodox doctrine emanating from London. However, they attached unorthodox importance to the export bonus aspect of the flow of silver to India. Unlike the British experts who saw in the export bonus only a temporary phase in the restoration of the automatic equilibrium, the nationalists emphasized the advantage which India had when selling goods to gold standard countries and the indirect protection which Indian manufacturers enjoyed against the competition of those who had to pay the cost of production in gold. They stressed the incentives to investors, the relief of debtors and—in the British-Indian context of an inflexible system of taxation—even the relative reduction of the burden of land revenue. They mentioned the growth of the Indian

16. On India's stable export prices see Fred Atkinson, "Silver Prices in India", in *Journal of the Statistical Society*, Vol. LX, 1897, p. 117.

textile industry in this period, and they resented just as much as William Jennings Bryan the "Cross of Gold" which they considered to be a common burden for the Indian peasant and the American farmer of those days.[17]

In reasoning along these lines most Indian nationalists did not raise the question whether the export of agricultural produce actually benefited India or not. Some had noticed that the area under cash crops had expanded even in famine periods when one would have expected a shift towards foodgrain, and they knew that the Indian peasant was not free to decide what he should grow because he was dependent on his creditors.[18] But they did not consider the wider context of this problem so as to find out about the adverse effects of the "export bonus". The indirect protection which India enjoyed due to the falling exchange may have been of some benefit to the tiny industrial sector but for the huge agricultural sector indirect production became a means of direct exploitation.

Flushing out India's Produce : The Discrepancy of External and Internal Prices

Keeping in mind that the gold value of the total stock of money in India remained more or less the same throughout this period of a rapid expansion of the currency we begin to realize how depreciating silver was used to flush out India's produce. At an earlier time the Dutch had adopted a deliberate method of extracting cash crops from Java by circulating a large amount of worthless copper coins.[19] In India the British did not have to do this deli-

17. For this argument see Dwijendra Tripathi, "The Silver Question : India and America", in *Journal of Indian History*, Vol. XLIV, Part III, Dec. 1966, pp. 789-798.

18. G. V. Joshi, *Writings and Speeches*, Poona, 1912, pp. 606 ff.

19. In his provocative study *Agricultural Involution—The Process of Ecological Change in Indonesia* (Berkeley 1963) Clifford Geertz points out how the colonial rulers "skimmed cash-crops off the surface of an immobilized agrarian society". But Geertz does not mention the monetary policy of the Dutch. This policy is described by N. P. van den Berg, *Munt Credieten Bankwezen, Hantel en Scheepvaart in Scheepvaart in Nederlandsch Indie*, The Hague 1907.

brately because by simply keeping the mints open to the free flow of depreciating silver they got practically the same result. The management of credit facilitated the extraction of cash crops. By advancing money to the peasants who grew cash crops for export the British and their agents preempted the productive capacity of India's agriculture. The area under cash crops expanded even at a time when food grain for home consumption would have fetched a better price. Wheat grown for export has to be rated as a cash crop in this context. The depreciation of the currency and the preemption of the productive capacity of vast parts of the country combined so as to achieve the miracle that India could export produce at "stable" export prices even at a time when severe famines tormented the country. By absorbing silver and exporting wheat at the lowest price India served as the buffer at the base of the world economy of the late nineteenth century. India was linked to the world economy in a most unfair manner. The "export bonus" provided by the depreciating currency imposed a pattern of trade on India which was not to its advantage.

The discrepancy of external and internal prices for India's agricultural produce was quite striking. The late nineteenth century witnessed a sensational fall in the gold prices of agricultural produce.[20] This led to a large scale reconstruction of the rural economy in Europe and America and to a new international division of labour. India was shielded against all that by its depreciating silver currency which provided it with its remarkably "stable" export prices. These stable prices referred only to the main export commodities like wheat and to the established export channels which were not necessarily linked with the whole internal economy of the country. Internally there was on the average a slow but steady trend of an increase in prices throughout this period.[21] Famine years and good harvests caused considerable fluctuations but the overall trend was nevertheless quite obvious. The combined impact

20. For the fall in gold prices see the index numbers of Augustus Sauerbeck published in his article "Prices of commodities and the precious metals," in *Journal of the Statistical Society*, Vol. XLIV, 1886, reprinted in E.M. Carus-Wilson, ed., *Essays in Economic History*, Vol. III, London 1962, pp. 68-127.

21. See Fred Atkinson, *loc. cit.*, 1903, p. 105.

of population growth and continuous depreciation and expansion of the currency helped to maintain the rise in prices. The trading practices of Indian grain dealers supported this trend beause they knew how to hold the price line even in years with a good harvest.[22] Due to the sufficient flow of money the system was not subjected to deflationary pressures which might have started an avalanche of falling prices.

Investment and the Emancipation of Debtors : A False Hope

Those who relied on the positive effect of the flow of silver, like the Indian nationalists who praised the export bonus, also hoped for the emancipation of debtors and the increase of investment generally associated with easy money. In other words, they hoped that the slightly inflationary trend would benefit the structure of the Indian economy. This trend and the prospect of growing export should have encouraged investment in agricultural production and freed the Indian peasant from his burden of indebtedness. But this did not happen. The increasing monetization enabled the rich to buy control over land without investing much in the improvement of its productive capacity. Population growth guaranteed that the control over land was worth buying because it meant that it would always be possible to exploit the man who tilled the soil rather than the soil itself. In keeping with this point of view the Indian creditor was not interested in the emancipation of the debtor. But unlike the conservative creditor elsewhere who insists on a stable currency in order to recover his money the Indian creditor had adjusted to the depreciating and expanding currency by perfecting his own methods of getting his pound of flesh. He saw to it that the debtor could never pay back his capital but would get caught in a web of compound interest so that he could never extricate himself from his bondage. The system of usufructuary mortgages was best suited to this kind of relationship, the creditor

22. Fred Atkinson, "Rupee Prices in India" in *Journal of the Statistical Society*, Vol. LXXII, 1909, p. 566.

became a *de facto* landlord and the debtor a permanent serf.[23]

It is easy to condemn the viciousness of this system and to deplore the depraved attitude of the Indian creditor who shirked the duties of a *bona fide* capitalist and investor and seemed to display the atavistic instincts of a petty usurer. However, we should not forget that the colonial regime and the development of the currency to a large extent predetermined this deviant behaviour. Even the richest men of India were excluded from the really substantial financial transactions which were based on the gold standard and controlled by the bankers of London. The easy access of the British-Indian Empire to the capital market of the metropolis which has often been praised as a boon to India's economic development was nothing but a curse in disguise. India's silver capitalists could not dare to enter the charmed circles of advanced imperial capitalism and they spent much of their money on landed property.[24] The often lamented Indian weavers who were driven back to the land by the powerlooms of Lancashire[25] have not been such a burden to Indian agriculture as the Indian capitalists whose attentions were diverted to the land by the City of London.

Gold and Silver Capitalism : The Double Standard and the Dual Economy

The Indian economy of the late nineteenth century developed a dual pattern of gold and silver investments. The loans raised directly by the British-Indian government in the London money market or the investment of the British firms to whom the government guaranteed a minimum profit belonged to the gold sector. The debt service for these loans became a burden for the Indian economy because the interest had to be paid in terms of the gold standard and the increasing depreciation of the Indian currency practically produced the same effect as the compound interest of

23. See Note on Land Transfers in Govt. of India, Dept. of Revenue and Agriculture, Land Revenue, Oct. 1895, Pro. No. 72-73.

24. *Ibid.*

25. See R. C. Dutt, *The Economic History of India under Early British Rule*, London (8th Impr.) 1956, p. 256 ff, on the Declin of Industries.

the usurer.[26] However, only the gold standard provided a stable foundation for long term credit; the depreciating silver currency was as unsuited as quicksand for such a foundation. The silver capitalist was therefore forced to concentrate on short term profit made in trading ventures or in moneylending of the kind which is not geared to long term investment.

The Rupee and the Sterling debt of the Government of India are of some interest in this context. In 1876 this debt consisted of 719 million rupees and 55.2 million pound sterling. Indians held only 142 millions of the rupee debt, the lion's share was in British hands. In the following years the rupee debt increased by about 30 million per year until 1884, when it reached a total of 931 million and remained more or less at that level for some years. In the meantime the Sterling debt had shown a steep increase from 59 to 69 millions pounds in 1879, had remained at that level until 1884 and then began to rise continuously from about 74 million in 1885 to 114 million in 1893. The interest rate on the Sterling debt was usually about 1% less than that on the Rupee debt, which increased from about 3 to 4% from 1876 to 1893 whereas the interest on the Sterling debt increased from about 2.5 to 3.5%.[27] These interest rates were, of course, very low compared to those which Indian moneylenders would charge, and, therefore, this kind of investment would not attract much Indian capital.

The dualism of gold and silver capitalism was not conducive to indigenous capital formation and economic growth which could only be based on a constant process of syphoning off capital accumulated by the agriculturist and investing it in industry. Monetization which is a prerequisite for this process does not necessarily induce the process if the currency is not sound and stable credit is available elsewhere. A slow inflation and indigenous investment based on an Indian money market could have gone a long way towards establishing a foundation for India's economic growth in the

26. See R. C. Dutt, *The Economic History of India in the Victorian Age*, London (7th ed,) 1956, p. 592 ff, on Finance and the Indian Debt.

27. C. N. Vakil, *Financial Development in Modern India, 1860-1921*, Bombay 1924, pp. 576-577 (Table showing the composition of the Indian debt).

late nineteenth century, but the dual pattern of gold and silver capitalism under a colonial regime frustrated these hopes.

Exchange Banks and Council Drafts

India had to pay her colonial rulers for the services which they rendered to the subject nation and this payment had to be made in gold. In addition to these so-called home charges there was the ever increasing debt service for the loans raised in London. These obligations forced India to export more and to import less. The depreciation of the silver currency meant that more and more silver had to be committed to the payment of these charges. This was the real "export bonus" which India obtained due to the free flow of depreciating silver.

The home charges were transferred by means of so-called Council Drafts which the Secretary of State sold against sterling in London and which were cashed by the Government of India. Theoretically the Secretary of State should have been able to sell these drafts to the highest bidder but in practice he sold them through a small group of exchange banks which were not interested in outbidding each other. These banks combined so as to keep the rate of exchange comfortably low and they were even prepared to ship more silver to India if they could keep the exchange rate down in this way. They could thus claim more rupees for the gold which they paid to the Secretary of State. In other words they inflated the Indian currency in order to make a profit on the exchange rate.[28] Their business was booming as the increasing depreciation of the Indian currency made it necessary for the Secretary of State to sell more and more Council Drafts. In 1873-74 the Government of India remitted 140 million rupees in this way, in 1892-93 it had to remit 265 million rupees.[29] The sale of Council Drafts was immediately reflected in the relationship between exports and imports. More drafts meant more export, a suspension of the sale of drafts

28. See Fred Atkinson, *The Indian Currency Question*, Allahabad 1894, p. 23.
29. Govt. of India, *Reports of the Currency Committees*, p. 1.

invariably led to an increase in imports.[30]

The whole system operated so as to inject inflation into the Indian economy and to extract a flow of cheap agricultural produce. It served the colonial power well and could have been perpetuated if it had not strained the resources of the Government of India which depended on a limited revenue.

The Closing of the Indian Mints : Fiscal Expediency

The government of a prosperous country can find ways and means for raising a revenue which is in keeping with the general rate of economic growth. The Government of India, however, could not do so and its main income was derived from such items as the land revenue and the opium and salt monopoly which were more or less static and inflexible.[31] Taxes like excise, sales tax, export and import duties would have enabled the government to ride the tide of inflation, but most of these taxes were explicitly denied to the Government of India because they did not fit in with the doctrines of free trade and the vested interests of Britain. The Government of India was after all a dependent government in a poor country and, therefore, its powers and resources were severely limited. The total home charges increased from 13.5 million in 1876 to 15.8 million in 1893. In the same period the land revenue, the largest single item in the British-Indian budget increased only very slowly from about 200 to 250 million rupees, and the gross customs revenue actually declined from an average Rs. 25 million per year during 1876-1888 to Rs. 10 million in 1884 and was still as low as Rs. 16 million in 1893. The total gross customs revenue for 1876-1892 amounted only to about Rs. 300 million whereas the loss of exchange incurred by the Government of India during this period was more than Rs. 770 million.[32] When, there-

30. See the note of H. Waterfield prepared for Lord Farrer in Farrer Collection, Vol. III, Item No. 58, British Library of Political and Economic Science, London.

31. See R. C. Dutt, *The Economic History of India in the Victorian Age*, p. 373.

32. C. N. Vakil, *op. cit.*, p. 583 f. (Tables showing the loss of exchange, revenue etc.).

fore, the task of collecting taxes in depreciating silver and paying the home charges in gold became more and more burdensome to the Government of India, it had to think of contracting and deflating the Indian currency by closing the mints.[33]

This radical step was taken only after a long period of prevarication. During the 1880s the Government of India had shared the universal hope for an international settlement of the currency question in terms of a bimetallist compromise.[34] It was only when the hope for an international settlement receded and when the American government proved to be unable to contain the flood of silver produced in its country by buying a large share of it at a fixed price that the British-Indian government resorted to the radical measure of closing the mints. This was done in 1893 and it had an immediate impact on America. Britain was pressed by America for a reopening of the Indian mints and there were many voices in Britain and India which echoed this demand.[35] Critics pointed out that the artificial appreciation of the currency which resulted from the closing of the mints amounted to a devaluation of Indian silver metal savings and to the imposition of an indirect tax on land revenue payers.[36] But as the government was in fact interested in an indirect tax it did well not to answer its critics and keep the mints closed.

A Gold Exchange Standard for India

Those who believed in the virtue of a gold standard would have liked to synchronize the closing of the mints to the free coinage of silver with the introduction of a gold currency. It was not easy to dispel the notion that a gold standard implied a gold currency. But the financial position of the Government of India precluded all

33. Govt. of India, *Reports of the Currency Committees*, p. 1 ff. (Lord Herschell's Committee).

34. David Barbour, *The Standard of Value*, London 1912, p. 178 ff.

35. See Dwijendra Tripathi, *loc. cit.*, p. 794 ff.

36. See the remarks of Mr. Moses in the Bombay Legislative Council, quoted in Govt. of India, Dept. of Revenue and Agriculture, Land Revenue, Dec. 1901, Proc. 26-27.

hasty experiments with a gold standard and a gold currency and necessitated a pragmatic approach to the management of the currency. Even the introduction of a gold exchange standard at the time of the closing of the mints would have been hazardous as it would have committed the government to the establishment of a fairly substantial gold reserve and it was anybody's guess what this reserve should be. Therefore, the government followed the safer course of simply watching the deflationary effect of the closing of the mints and waiting until the rupee had reached the exchange rate of 1s. 4d. at which the government wanted to stabilize it.[37]

The contraction of the currency took some time. In the few years immediately following the closing of the mints silver continued to pour into India and the exchange rate fell somewhat more but did not drop as much as the metal itself.[38] Soon the contraction was felt and the exchange rate rose and by 1898 reached the point where it could be supported by a gold reserve at the rate of 1s. 4d. The sale of Council Drafts could now be employed as a device for the management of the currency.[39]

Putting the development of the currency into reverse gear was certainly necessary but it inevitably caused a great deal of distress. The cash commutation of rents in kind, the land revenue assessment of the peasant, the relation of creditor and debtor in the rural areas which had all been shaped by an expanding and depreciating currency were affected by the contraction and deflation which set in after 1894.[40] Two years of bad harvests added to this calamity and famine spread in India. The contraction of the currency was paralleled by a contraction of population growth.[41] After having been drowned in a sea of silver India was now nailed on a "Cross of Gold".

The Effect on India's Economic Structure

India was shielded against the effects of the world agrarian crisis behind the wall of its depreciating silver currency. Therefore, it

37. See David Barbour, *op. cit.*, p. 207 ff.
38. *Ibid.*, p. 208.
39. *Ibid.*, p. 217 ff.
40. See Note on Land Transfers (Footnote 23).
41. See *Census of India* 1901.

did not have to adjust and modernize its agricultural modes of production. It was only partially exposed to the forces of an emerging world economy. It was used as a buffer and it did not get into the mainstream. At the time when the world agrarian crisis subsided at the end of the nineteenth century India was pushed into a deflationary phase for purely fiscal reasons. It was subjected to severe strain in order to achieve what British contemporary observers considered to be a sound economic basis, because they looked at it from a monetary point of view, but it did not gain any structural benefits from this new phase either. The banking principle and the currency principle provided the guiding lines for partisan arguments about Indian economic affairs at that time and the Indian economist Mahadev Govind Ranade who was groping for structural modes of analysis[42] was a lone sentinel whose voice was not heard in the councils of those who determined India's fate in the interest of British imperial policy. In the twentieth century India suffered from this heritage of the nineteenth century and could not overcome the handicap of a hidebound agricultural sector and of a stunted capitalism which was tied to trade and usury at a time when it should have laid the foundation for India's future economic growth.

42. See M. G. Ranade, *Essays on Indian Economics*, Madras 1920.