Remembering BR Ambedkar as a monetary economist

Ambedkar argued that the gold exchange standard during colonial India was flawed. While it did restrict private citizens from minting silver to coins, it did not prevent the Indian government from doing so

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Highlights

- *In early 19th century under colonial rule, the rupee was essentially a minted piece of silver metal of 92 percent purity*
- *Britain was on gold standard while other major economies followed silver, keeping a stable fixed exchange rate between the two metals*
- *Countries began to abandon silver after mid-nineteenth century, causing a sharp depreciation of the silver rupee versus other currencies without balance of payments issue*
- *Gold exchange standard was adopted, which Ambedkar later in his book criticized and argued that it prevented citizens from minting silver to coins but not the government*
- *Ambedkar's views as an economist left little space for fiscal deficits and more generally, fiscal policy*

Today, the 14th of April, is the 132nd birth anniversary of Dr. B.R. Ambedkar, whose role as a political leader and social reformer has been universally recognised. However, as an economist his contributions may perhaps be less familiar to many. This year also happens to be the 100th year since the publication of one of Ambedkar's most notable works in monetary economics, '*The Problem of the Rupee: Its Origin and Its Solution*,' which, as he articulated in the Preface to his book, was an examination of the theoretical basis of the gold exchange standard.

This essay in remembrance of Ambedkar explores his critical economic analysis of, and more specifically, his decisive arguments against the gold exchange standard introduced in India by the British colonial government at the end of the nineteenth century.

A good starting point to comprehend India's modern monetary history is the year 1835 when the English East India Company introduced a common monometallic silver currency, the (new) rupee for the whole of British India. The rupee was essentially a minted piece of silver metal of 92 percent purity weighing approximately 11.66 grams, which would serve as the unit of account and legal tender.

Historically, when several major economies like France, Germany, and the United States were on a silver standard while Britain was on gold (sovereign), international bimetallism had ensured the stability in the price ratio of silver to gold at about 15.5:1 over centuries, tantamount to a fixed exchange rate between gold and silver currencies of the world during that period. However, when countries began abandoning silver in the decades following the mid-nineteenth century, the price of silver declined sharply from around 1870, which consequently led to the free fall in the value of the silver rupee vis-à-vis gold currencies.

A depreciating rupee was considered problematic – not to Indian exporters – but to some very powerful entities: the British Indian government and British officials in India. The former was concerned over the rising silver rupee costs of sovereign (British gold currency)-denominated 'home charges' to be repatriated from India while the latter were anxious that their savings in silver rupees would fetch fewer sovereigns on their return to Britain. In 1893, it was finally decided to put an end to the depreciation of the rupee, which had wholly arisen from the falling price of silver and not because of balance of payments deficits.

The first step in this process was to close the mints to the unlimited coinage of silver bullion into rupees. This essentially meant that the rupees in circulation were either paper or token coin (that had already been issued) passing above its intrinsic value (the bullion price of silver). In other words, the rupee was delinked from the price of silver bullion. The immediate question which then arose was what the rupee would be pegged to given that a fixed exchange rate system – which supported international trade and capital flows by eliminating the risks of fluctuating rates – had to be implemented. Two options were possible: the first, a gold standard or second, a gold exchange standard.

Ambedkar was in favour of the first; a rupee currency fixed in issue (supply) with gold as legal tender. Silver coins were to be gotten rid of. Further additions to the supply of money in India over time would arise from the minting of coins at a fixed rate when gold was imported by way of Indian exports. He was categorical in his criticism of the Fowler Committee report of 1898 – dismissing it as 'classical for its nonsense' – not because it had called for India moving on to a pure gold standard with the sovereign as standard coin, but because it recommended that the 'Government should coin rupees on its own account according to that most naive of currency principles, the requirements of the public.' Ambedkar asserted that any arbitrary expansion of money was destabilizing and by allowing such a possibility, the Fowler Committee had actually paved the way for the introduction of A.M. Lindsay's scheme or the gold exchange standard, which, interestingly, it had dismissed as inappropriate.

Lindsay, however, was confident that although the British desired that the rupee be pegged to gold so that a fixed exchange rate between the rupee and sovereign prevailed, they certainly did not want gold to physically circulate in India (or to leave Britain). The reason was simple: India was known as the sink of precious metals and the world feared that with a perpetual surplus in its balance of payments, gold entering India would be hoarded, causing shortages for coinage and deflationary pressures internationally. Lindsay had therefore conceitedly professed, 'they [Fowler Committee] must adopt my scheme despite themselves.'

Lindsay was proven right as his scheme was adopted in toto. The rupee-sterling exchange rate was fixed at Rs.15 = £1 or Re.1 = 1s.4d. (1 shilling and 4 pennies), which in turn was convertible into gold at a fixed rate of £1 to 7.32 grams of gold. The Indian government was bound to give Rs.15 for a sterling pound but the rupee was convertible into gold only at the discretion of the government. There was no gold coin in circulation in India. Since India usually had a balance of payments (excluding home charges), the rupee could appreciate so that British importers would have been tempted to export gold to India to claim Rs.15 for a sovereign. To overcome this, the Secretary of State for India, agreed to sell 'Council Bills on India' in London at the rate of 1s.4½d., the gold export point for Britain. The Council Bills were also used to enable Indian borrowings in Britain necessary for the railways and other large-scale projects. The lenders would buy Council Bills in London and send them to their Indian borrowers who could claim the amount from the Treasury in India. Moreover, after the payment of home charges, there was no significant imbalance in India's balance of payments so that the exchange rate was not expected to touch Britain's gold export point.

Ambedkar argued that the gold exchange standard was flawed. While it did restrict private citizens from minting silver to coins, it did not prevent the Indian government from doing so. Using the argument that it was being responsive to the needs of domestic industry and trade, the British-Indian government in the position of a monopolist was prone to over-issuing rupees given the difference between the gold price of the rupee and the gold price of silver (the silver rupee was overvalued vis-à-vis bullion). Between 1905 and 1907, the Government of India minted coins to the tune of some £42 million, one of heaviest coinages in world history (until then). Not surprisingly, allegations emerged against government officials and M/s. Samuel, Montagu & Co., merchant bankers and bullion dealers, for manipulating prices at which silver was purchased for coining. This 'fatal facility', Ambedkar argued, was what led to significantly higher rates of inflation of almost 30% in India as compared to Britain between 1900 and until the First World War in 1914, severely impacting India's poor who were already reeling from famines and deindustrialization.

Believing that Indians would hoard gold rather than use it as currency had also prompted John Maynard Keynes to favour Lindsay's gold exchange standard. At the same time, Keynes acknowledged that 'keeping Indian prices stable in relation to commodities rather than in relation to any particular metallic or particular foreign currency' was of paramount importance. Ambedkar opposed this inconsistency in Keynes' view given that gold exchange standard failed in this very aspect. To maintain the price level, Ambedkar unequivocally contended that this was possible only if there were limits to the expansion of money supply: the convertibility of the rupee into gold was necessary not as an end in itself but as a means to control supply of the rupee. The gold exchange standard did not restrict issue of the rupee and an inconvertible rupee had allowed this to happen, resulting in rising price levels in India at the turn of the twentieth century.

By 1917, the impact of the war on the British economy and its currency brought an end to the gold exchange standard.

Looking back, it seems that Ambedkar's views against any possible arbitrary increase in money supply are more akin to the Quantity Theory of Money, and those of Milton Friedman's monetarism. In other words, Ambedkar left little space for fiscal deficits and more generally, fiscal policy. For a follower of Modern Money Theory (MMT) and post-Keynesian thought, this is indeed disheartening. Ambedkar's argument must, however, be seen in its historical context: the world then was operating under a fixed exchange rate regime. The present-day floating exchange rate system provides a higher degree of monetary sovereignty and greater fiscal space; an essential element of 'modern money' and a basic tenet of MMT.

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