1

Revival of the Indian Capital Market*

CAPITAL market is an indispensable institution in an economy where private sector has to play a major role. There are no two opinions on the point that all is not well with the Indian capital market. An attempt has been made in the succeeding pages to analyse the present state of the capital market and suggest remedies for its revival.

State of the Capital market

The capital market during the last 10 or 12 years falls into 3 well defined phases. The first phase was the period between September, 1956 and March, 1958, when the share prices remained depressed. The imposition of excise duty on cloth in August 1958, foreign exchange crisis, followed by restrictions on imports, re-imposition of capital gains tax, increase in excess dividend tax in November, 1956, imposition of two new taxes—the wealth tax and the expenditure tax in May 1957, all combined to cause a decline in the index of variable dividend industrial securities (base 1949-50=100) from 126.9 in September 1956 to 96.5 in March 1958, showing a fall of about 24% over a year and a half.

The second phase was the period of recovery and bouyancy from April 1958 to May 1962, during which the rise in equity prices was 57.2%, the average annual rate of increase being 14.3%. This recovery was helped by the better prospects of foreign aid, expectation of bonus issues by some of the leading companies, reduction in excise duty, suspension of compulsory deposit scheme for companies, and a favourable budget for 1960-61 followed by a reduction of tax on bonus issues announced in the budget for 1961-62. During this period, companies which issued new capital found absolutely no difficulty in having their capital subscribed by the public, and in several cases the issues were over subscribed by many times. In fact the subscription in some cases was as high as 50 times or even 100 times the amount of capital offered for public subscription. During this phase of the capital market there was considerable interest on the part of middle class and even lower

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class of persons to invest in equity shares, and lacs of people who were not formerly investing in industrial securities, willingly and even enthusiastically subscribed in fresh issues of capital, because new issues often commanded good premium even before the subscription lists were closed. This period was in fact the golden period of the capital market.

The third phase of the capital market was again a period of depression from June 1962 onwards. Among the factors which led to the debacle in share prices were substantial reduction in retention prices of steel than those recommended by the Tarrif Commission, the Chinese aggression in October 1962, a frightfully heavy budget in February 1963, followed by the Indo-Pakistan conflict in September and October 1965, increase in Reserve Bank of India's bank rate from 4% to 6%, the severe drought during two successive years 1965-66 and 1966-67 and various other factors. The economic situation during the last 2 or 3 years has completely changed for the worse, and the seller's market was converted into the buyer's market, industrial production suffered, prices shot-up, and there was even recession in several sectors of the economy. This period of depression still continues, relieved only by minor rallies in the prices of shares from time to time.

The recent study of capital market made by the National Council of Applied Economic Research giving a comparison of share price performance in India with 27 countries, covering both advanced and developing countries during the period 1953 to 1965, showed that India falls in the lowest category of 9 countries which showed a lower price increase than the median share price of all the countries. A comparison of the quarterly movement of share prices from 1957 to 1965 with the U. K., U. S. A., Japan, Australia and France showed that in these countries there was much lesser decline or a much greater rise than in India. With 1961-62 as the base year index as 100, the index in September 1967 for equity shares stood at 77.8, which is a substantial drop indeed. At the same time the index of whole-sale prices appreciated from 125.1 in 1961-62 to 222.3 in September 1967. A study of the Economic Times showed that two-thirds of the new issues during the last few years were taken-up by the underwriters, and of the remaining one-third a substantial part was taken up by the foreign collaborators and their friends, while just about one-sixth of the total fresh capital came from the public proper. Out of 263 new issues with a paid-up capital of Rs. 165 crores that came to the market between January 1961 and June 1967, as many as 144 or more than 55% were quoted below par at the end of June 1967, 69 or about 25% were quoted nominally at par and the remaining 50 or only 20% were quoted at a premium.

Many new issues were selling at heavy discounts, 44 of them being quoted at discounts exceeding 40%. Groupwise, except chemicals, all other sectors of industry, whether engineering, paper, cotton, textiles, cement or others, depreciated in value, the fall ranging on an average from 11% to 30%. All in all, a study of the capital market during the last 10 or 12 years shows that investors in shares in India have suffered badly on their equity investments. The shareholders not only failed to get reasonable dividends, as compared to returns from other investments, but also their shares have depreciated considerably and the capital value of their investments h ave also eroded as a consequence. The study of the National Council of Applied Economic Research states thus "The continued sluggishness of the market in India has no parallel in other countries; it is something special to India and reflects Indian policies and Indian performance. International comparison of the share price movements during the last fifteen years confirms this. The decline in real savings is certainly a part of the explanation; but the diversion of savings to alternative forms of investment, some of them quite unproductive is considerably more important."

Need for revival of Capital Market

It is pertinent to enquire what is the need for revival of the capital market. It has been rightly said that "the throb of the various constituents of the capital market is a sign of the nation's economic health". Lack of a healthy and active capital market deters mobilization of savings of the public for industrial development, while an active capital market enables the economy to go forward. In recent years, many industrial units could not be set-up, because while the enterpreneurs were able to make arrangement for purchase of machinery and equipment from abroad and were also able to secure foreign know-how, they have not been able to obtain the necessary rupee capital. If, as has been the case in India during the last 6 or 7 years, the corporate sector experiences difficulties in raising capital from new issues, industrial development of the country inevitably suffers. The late Dr. John Matthai, a former Finance Minister, had observed in his speech on the Budget for 1950-51 thus, "Unless the incentive to save and invest was revived, the industrial expansion of the country and the execution of the plans for raising the living standard of the people were bound to be delayed." At the time of announcing his scheme of tax credit certificates for investment in new equity shares in December, 1964, Mr. T. T. Krishanamachari, the then Finance Minister, frankly admitted that the investment climate needed to be improved and pointed out that plans for industrial expansion weer suffering because it had become difficult to raise capital, especially equity capital, for new Companies.

The draft fourth Plan made an allotment of about Rs. 7,000 crores for the development of industries in the private sector. Although the formulation of the fourth plan will now have to await the return of normalcy disturbed by two successive years of drought, there is bound to be a heavy investment in the private sector, whether there are one-year Plans or five year Plans. How are these targets going to be translated into factories and manufacturing units with the capital market down in the dumps ? The most urgent task facing the country is that of accelerating economic development and this cannot be done without measures to revive the capital market.

Steps for Revival

Let us now consider the various steps that need be taken for the revival of the capital market. These steps can be classified into the following broad categories:—

1. Economic climate and Psychological measures.
2. Fiscal measures.
3. Monetary measures, and
4. Miscellaneous measures.

First, let us see in what manner a change could be brought about in the economic climate or the psychology of the investors for committing their savings to industrial securities, rather than to other forms of investment, such as land and property, bullion, fixed deposits with banks or other business concerns, hoarding of commodities, and so on. However, even before the question of investment could arise, they have to have the money to invest. Such money has to come from savings, unless one is lucky enough to have inherited a fortune from his forefathers. When economy is in good shape, and incomes rise faster than expenditure, more and more savings are generated for investment. Unfortunately, the position during the last few years in India has been that expenses have been running faster than income. People's incomes, and therefore the total volume of savings, have been getting reduced. This is no less true of the Government than of individuals or companies. In fact it is much worse in the case of the Government, than what it is in the case of the individuals. The Government have been running into huge deficits year after year. The Government was compelled to spend larger amounts on defence, after its experience of the border war with China in 1962 and with Pakistan in 1965. The Government prepared its five-year Plans perhaps a little more ambitiously than the available resources may have justified. Large amounts of public funds were committed to public sector undertakings, on which there was little or no return. To meet its needs,

the Government was compelled to increase direct and indirect taxes all-round. The increases in turn led to inflation, and increase in the prices of various commodities. Between higher taxes and higher prices, the individual come to have lower and lower savings for investment. The rate of domestic savings, after having gone up from 5% of the national income to 10% during the second plan period decreased to 8% in the third plan period, and is now lower at 6%, according to a recent statement of the Union Minister of State for Finance. In this process, the nature also had its hand, as the years 1965-66 and 1966-67 were years of severe drought in India. Fortunately, during the current year, agricultural production is expected to reach a satisfactory level of about 100 million tons of food grains production. It looks as if the dark clouds on the economic horizon have started receding, and there may again be sunshine on the price front. If this happy development takes place, it would remove one important hurdle in the way of recovery of the capital market, as there will be additional money in the hands of the producers. However, the situation still needs to be watched, and unless the next harvest is also satisfactory, there may again be trouble. The problem of increasing the volume of savings for investment in the hands of the people also depends a good deal upon the tax policy of the Government, for which one has to await the forth-coming budget of the Central Government.*

Apart from the people having savings to invest, it is very necessary that the savings should be attracted towards industrial securities rather than get diverted towards competing forms of investments like land and property, bullion, deposits, stocks of commodities etc. A mere patriotic appeal for investment in industrial securities is not going to make people to invest in shares. Before they could invest in industrial securities, such investment is to be made sufficiently attractive through additional incentives. Also, the entrepreneur should consider it worth-while to venture into and to invest in new undertakings, while the ordinary shareholder should be compensated for risk bearing as against other competing investments which are safer. Unproductive forms of investment must be made less paying by greater accountablity and higher taxation. The investor will not be so foolish as to invest in equity shares and take all the risk, when it is open to him to invest his savings in other forms of investment for greater gain and lesser risk.

Let us consider what returns investors in shares have obtained in recent years, and how such returns compare with other forms of invest-

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*The New Budget for the year 1968-69 was however, presented on 29th February 1968. A series of fiscal concessions have been granted, which have been analysed elsewhere in this issue. Editor.

ments. The returns to the shareholders comprise of both dividend yield and change in the maket value of shares for the period 1955 to 1966. The average annual return to the individual shareholder in India was only 8.06% as compared to 13.4% in U. S. A. During the third plan period, the return was only 3·24%, which was less than one-third of the corresponding return of 10.28% in the U. S. A. The return on industrial securities in India was barely 1.13% in 1964–65 and 1.18% in 1965–66. The investors in issues of new companies fared very badly indeed. In respect of these issues made during the period 1956 to 1961, the returns since 1961 have been negative almost in all cases, the figures sometimes being as low as minus 29%. As against this picture of return on industrial securities, the returns on other forms of investment have been very much more attractive during the same period, returns including both income-yield and price change. In the case of investment in land, the return has been as high as 25% to 100% per annum. In the case of gold and silver, the return has been about 11% per annum. In the case of deposits, the return has varied from 7% to 12%, while in the unorganised money market, deposits have fetched a return of 9% to 15%. Even in the case of debentures, the return has ranged from 6% to 7% and on preference shares it has ranged from 7% to 9%. This comparison makes it clear that investors have shyed away from equity investment in industrial enterprises, and have preferred to invest in other forms of investment, like land, bullion, hoarding of stocks of commodities, and the like. Even among the various forms of industrial securities, there is an increasing preference for debentures and preference shares, which are considered more stable and less risky than equity shares. So far as an individual is concerned, it does not matter to him whether he obtains his earning from investment in equity shares of industrial concerns, or whether he obtains it from transactions in land, or from accumulation of gold, or from hoarding of commodities. But from the point of view of the economy of the country, it is necessary and desirable that savings of the people should be increasingly utilised for keeping the wheels of industry moving faster and treading into new areas, rather than that the savings are invested in unproductive forms like land or bullion or speculative hoarding of commodities. Industrial units represent production of more and more goods for the country as well as for export, and it is obvious that the capital market should be in such a shape that the maximum amount of savings of the people should be attracted towards long-term investment in equity shares of old as well as new companies. This explains the need for giving all possible incentives for investment in industrial securities and, negatively, for taking steps to prevent the attractiveness of other unproductive forms of investment.

While considering the psychological back-ground for stimulating investment in industrial securities, it is also necessary to ensure that the companies are enabled to earn more profits and to pay better dividends to the shareholders. It is also necessary to ensure that when the interest rates go up, and correspondingly the expectation of yield from equity investment also goes up, the shareholders may be able to obtain a better yield on their investment. What has actually happened during the last few years is that neither the net profits of companies nor the dividends of shareholders have increased. According to the Reserve Bank of India study of Joint Stock Companies, between 1960-61 and 1965-66, profits after tax were slashed by about 20% from 5.1 to 3.9 as percentage of sales, from 5.1 to 3.7 as percentage of total capital employed, and from 10.9 to 8.9 as percentage of net worth. Over the same period, dividends as percentage of paid-up capital dropped from 11.2 to 10.2 and as percentage of net worth from 6.6 to 5.1, the fall being of the order of 9%, and 23% respectively. In striking contrast, during these years, even the Reserve Bank's Bank Rate was stepped up from 4% to 6%, representing an increase of 50%, and the other interest rates recorded a much steeper rise. In fact, on account of increased tax liability on corporate profits, most of the companies in their attempt to maintain the quantum of dividend distribution, were compelled to reduce their ploughed-back profits. That being so, the shareholders were unable to earn a higher yield on their investment in shares, when interest rates and commodity prices shot-up in the market.

While discussing about the psychological encouragement to investment in industrial securities, it is also relevant to refer to the need for a basic change of attitude towards the capital market on the part of the Government authorities. Stock Exchanges are the instruments of capital market, and many responsible ministers are often heard talking of Stock Exchanges in disparaging terms like the "gambler's den" or "the speculator's paradise". Mr. T. T. Krishnamachari, when Finance Minister, several times stated that the Stock Exchanges were not a correct barometer of the state of the economy. Once he even stated that "if the Stock markets do not behave, he will have no use for them". On another occasion, he said, "if the price of Indian Iron is Rs. 24.50 today and it becomes Rs. 28.50 day after tomorrow, does that mean an extra spoon of sugar in any body's cup of tea"? Mr. Morarji Desai, the present Finance Minister, has also some time, been giving expression to similar sentiments. Speaking in Bangalore the other day, he is reported to have said that it is the people themselves who were responsible for the crisis in the capital market since 1962, implying thereby that the Government deserved to be given a clean chit. He failed to see the patent illogicality of the assertion by not

realising that investors could not be so foolish as to cut their nose to spite their face. It is such kind of statements from Government authorities which damage the climate for investment in industrial securities, as they rightly make investors feel that the Government is not favourably disposed towards risk-bearing investment. So long as there is a private sector in India, to which an important role is assigned in the economy of the country, the economy is bound to remain inextricably mixed-up with the capital market, and it is futile to hope that there can be a revival of the economy without a revival of the capital market. In contrast to this position in India, in several other countries which have made rapid economic advances, deliberate and conscious efforts were made by the Governments to promote investment in industrial securities. In West Germany, for instance, all manner of propaganda was made and measures were taken to promote investment in industrial units, which resulted in its economy recovering rapidly under Erhard Ludwig after the ravages of the Second World War. In the United States of America, likewise, more and more persons are encouraged to invest their savings in industrial securities, and Government efforts are directed towards that end. So is in Japan, and several other countries. The position has been beautifully summed-up in the study of the capital market by the National Council of Applied Economic Research in the following words:—

> "*What seems essential is a change in the Government's outlook towards investors and investment in industrial securities in general. Investors are not money-bags; they are the thousands of the middle and lower income groups who are willing to channel their modest savings to support the country's industrial ventures provided their savings are intact and as reasonable return is assured to them. It is the absence of this basic acknowledgement on the part of the Government that is really behind the currently deplorable state of the investment market*".

Fiscal Policy

Let us now discuss the role of the Government's fiscal money in the capital market. Fiscal policy plays a very important part in shaping the state of the capital market. When severe taxes are imposed on companies and individuals, equity prices at once tumble-down. On the contrary, when there is tax relief, equity prices go-up. This is very natural indeed, because a company has first to pay tax on its earnings before it can distribute dividends, and the extent of the distributable profits depends upon the size of the hole in the pocket of the company made by taxes payable to the Government. If a company

makes a net profit of Rs. 100/- it has first to pay Rs. 55/- to the Government by way of income-tax (tax liability may be higher on account of surtax, or on account of disallowances of expenses etc.) and it is only out of the balance of Rs. 45/- that the company will pay dividend to the shareholders, who will have to pay their own taxes on the amount of dividends at their applicable individual rates of tax, which may be as high as 85% or 90% and with the addition of Wealth Tax and Gift Tax, may even exceed 100% of the income. It will thus be seen that out of every Rs. 100 earned by a company, a large chunk is appropriated by the Government, and the balance amount available to a shareholder who has contributed to the capital of the company would be a very small fraction of only about 10 or 15%.

The tax system in India is much more onerous on the corporate sector than it is elsewhere. The corporate tax is 55% in India, and it is much less in other countries like the U. S. A., the U. K. etc. The proportion of taxes to total profits is only about 33% in the U. K, about 43% in the U. S. A. and 40% in Japan. Income-tax in India increased from 131.35 crores in 1955-56 to 185.96 crores in 1962-63. In 1963-64 it went up to 258.60 crores, while the budgeted figure for 1967-68 amounted Rs. 290 crores. The burden of corporation tax increased even more sharply. From Rs. 37.04 crores in 1955-56, the corporation tax increased to Rs. 156.46 crores in 1961-62. It galloped to Rs. 221.50 crores in 1962-63, Rs. 274.59 crores in 1963-64, Rs. 314.05 crores in 1964-65 and Rs. 350 crores according to the budget for 1967-68. Apart from these direct taxes the burden of customs duty increased from 166.70 crores in 1955-56 to Rs. 643.08 crores in 1967-68, while the burden of excise duty increased from 145.25 crores in 1955-56 to as much as 1214.04 crores in 1967-68. The study of the National Council of Applied Economic Research clearly shows that the retained profits of companies have considerably declined over the successive Plan periods—the decline being very substantial in the case of large companies (with paid-up capital of more than Rs. 1 crore) particularly since 1960-61. The study, therefore, rightly states that "there is not the slightest doubt that the major factor responsible for the poor shape of the capital market is the Governments fiscal policy"

Suggestions for tax incentives in India—It would greatly help the capital market in India if the effective rate of tax on public companies is reduced to a uniform rate of 45%, from the present rate of 55%. If this change cannot be brought about at once, having regard to its impact on Government revenues, the reduction could be effected gradually over 3 or 4 or even 5 years. The surtax on companies should also

be abolished, as it is largely a tax on efficiency. In any case the maximum over-all tax liability on companies should be lowered to 55%, as against the present ceiling of 70%, which is fantastically high indeed.

Apart from companies, incentives need to be given also to individuals to save and invest. Assistance may be derived from the various kinds of incentives for investment in shares given by other countries. If capital gains on sale of shares could not be given up altogether, the base for the purpose of computing capital gains should be taken as the market value as on 1st January 1963 or 1964, instead of 1st January 1954 as at present. Market value as on 1st January 1954 provides an unrealistic basis of comparison. Instead of allowing tax exemption only if the total dividend income is not more than Rs. 500/-, dividend income upto Rs.2,000/- should be treated as exempt in all cases. Inter-corporate dividends should be totally exempt from tax. Distributed profits should be either not taxed at all in the hands of the company, or taxed at a substantially lower rate than retained profits, as is in West Germany. There is justification for allowing dividends paid as a deduction from the corporate base, in the same manner as interest or wages paid are allowed as a deduction. In any case, 7·5% dividend tax on equity dividends in excess of 10% of the capital is entirely irrational and should be scrapped. There should be no deduction of tax at source on all dividends or at least when the dividend paid does not exceed Rs. 400/-, as in the case of payment of interest. Again, as in the case of interest, the rate of tax deduction at source should be reduced from 22% to 10%. Tax credit certificates on equity shares are too cumber-some and the relief is too small; they should either be liberalised or scrapped altogether. Instead, there might be an investment allowance, on the lines of payment of life insurance premium or contribution to provident fund. If the scheme of annuity deposits could not be scrapped altogether, it may be provided that fresh investment in equity shares would be adjusted towards payment of annuity deposit. The adoption of such tax incentives for equity investment would go a long way to revive the capital market and place the economy in a cheerful and healthy state.

(Under the Finance Bill of 1968, it is proposed to abolish the equity dividend tax on companies, and to reduce the rate of Surtax for companies from 35% to 25%. It is also proposed to withdraw the Annuity Deposit Scheme for individuals, and to exempt first Rs. 500/- of dividend income from tax in all cases. Special surcharge on unearned income above Rs. 30,000/- and earned income above Rs. 1,00,000/- is also proposed to be abolished).

Monetary Measures

Let us now discuss the monetary policy and its impact on the capital market. It is undeniable that the monetary stringency and the prevailing high rates of interest in the market have contributed to the sluggishness of the capital market. It is obvious that with the difficulty of obtaining money for industrial enterprises, and the high cost of the money even when it is available, the enterpreneurs are deterred from venturing into new enterprises, or expanding the existing units. India does not have a tradition of high interest rates. For the past 20 years and more, until 4 or 5 years back, the structure of interest rates was quite low than the now prevailing rates of interest in the market. Low interest rates could be maintained during the depression of the thirties and during the years of the Second World War. Throughout the fifties, during the first two Plan periods, a moderate interest structure was preserved with healthy effects on the economy. The bank rate was raised from 3 to 3.50 percent on November 15, 1951, and to 4 percent on May 16, 1957. During the Second Plan period of 1956 to 1961 when there was rapid industrial progress on a broad front, the economy was fast expanding, and there was an all-round feeling of buoyancy and optimism among the people, monetary authorities followed a policy of low and stable interest rates, which greatly facilitated economic growth. During the 3rd Plan period 1961-1966, there came two border wars with China in October 1962 and with Pakistan 3 years later, which disrupted the Indian economy and stretched the Government's need for defence expenditure a good deal. There was an increase in bank rate first from 4% to 4½% from January 3, 1963 then 4½% to 5% from September 26, 1964 and from 5% to 6% from February 17, 1965. To fight the alarmingly inflationary price situation, basically caused by the drying up of sources of supply of essential articles, Government resorted to higher and higher direct and indirect taxation in one budget after another and to higher interest rates and penal rates, besides qualitative and quantitative restrictions on the supply of credit. After the increase of the Reserve Bank of India rate to 6% in February 1965, the commercial banks lending rate soared to 9 to 10 per cent, the bazar rates went up far beyond, hitting particularly the small man and causing a veritable scramble by trade and industry for credit at any cost. When organised banking system could not provide it, trade and industry rushed to outside private sources to borrow money at any rate even 12% and more. This condition in turn disrupted the investment market and the stock market, where decline followed decline. Apart from the support of the financial institutions, the capital market has since been deserted by the investor.

Joint Stock Company managements not finding the capital market active and having no confidence to come to the open market for capital resources for expansion programmes, now switched over to public deposits offering higher rates of interest. This has been accentuated by the credit squeeze introduced by commercial banks, as a result of directives and instructions from the Reserve Bank of India from time to time. The rates of interest on these company deposits, in many instances, are much higher than the pattern of yield on equities in share bazar. It is estimated that the present quantum of company deposits is of the order of Rs. 250 crores. It may be noted that, from the point of view of the company, payment of high interest rates do not matter much. Interest paid being treated as business expense, and the company rates of tax being 55% or even higher, the net loss to the company from interest payment is less than half of the amount of interest paid-out. In fact payment of dividend at the rate of $5\frac{1}{2}$% to shareholders is equivalent to interest payment at the rate of 12%, because interest paid is an expense, while the dividends have to be paid out of profits after tax. Hence instead of paying barely 9% dividend on shares, if the company pays even 12% interest on the, amounts borrowed as deposits, the company is better off.

There is no doubt that the pattern of high interest rate currently prevailing is a major cause for keeping the stock market and the capital market depressed. Recently the Reserve Bank has begun to take some measures to liberalise credit, more with a view to counter industrial recession, for instance by agreeing to charge low rate of interest for credit for export. We are already beginning to witness the benefits of the relaxation, though much more needs to be done. For the first time in recent years the money market in December 1967 and January 1968 showed a distinctly easy position, and Bank's deposits continued to increase, if, as is likely, the money market in 1968 remains comfortable, it would be a good idea to reduce the Reserve Bank of India's bank rate from 6% to 5% on 2nd March 1968 Reserve Bank has lowered the bank rate to 5% and also to reduce the maximum rates of interest charged by commercial banks on cash credit or over-draft accounts. This step is bound to boost-up the capital market and the economy, because a fall in the Reserve Bank's rate would serve to reduce the rates of interest charged by commercial banks and also those in the unorganised money market. Such reduction would also reduce the expectation of return from industrial securities in the minds of investors thereby leading to an increase in the rates of such securities.

When the Reserve Bank rate was increased to 6% in 1965, it was done under external pressure as an alternative to the devaluation of the

rupee for which the International Financial Agencies saw the need. Now that the rupee was drastically devalued in June 1966 there is in fact a justification for reduction in the bank rate.

It is not that the present Bank rate of 6% in itself can be regarded high, but the effect which the bank rate has on the totality of interest rates in India is the crux of the matter. In India the impact of the bank rate on other rates, is much more than in advanced countries. With the bank rate in India at 6%, the bazar rates rules to a reasonable level all along the line. It is not easy to see how business particularly small business, can be profitably run in India after paying these high rates.

Economists hold the view that high rates are necessary in times of inflation because they tend to keep down inventories, whose building up is often a cause of inflation. However, under the prevailing conditions in India, costs need to be lowered to keep inflation under check. Interest is first an item of cost and this cost has risen considerably in recent times. A reduction in this cost is as necessery as a reduction in other directions. Ordinarily cost of financing does not constitute too high a proportion of total costs of industry, but the large increase in financing charges in recent years has become an onerous burden to industry.

Miscellaneous Suggestions

Few other suggestions to revive the capital market may be as follows:—

1. It would help the recovery of the capital market if bank advances against shares are liberalised, instead of being placed under fresh fetters. Recently the Reserve Bank of India issued guidelines to scheduled Banks as regards advances against shares, and repayment schedules of loans already advanced. Acting on these guidelines, several scheduled Banks have recently discussed with their clients, who had availed themselves of advances against shares to settle the question of the advances being gradually reduced. The fear that the advances against shares are either excessive or that they are being used for speculation is unjustified. Advances against the security of shares of Joint Stock Companies as on 30th June 1967 comprised of only Rs. 84.69 crores, which is barely 3.21%, of the total advances of Scheduled Banks on that date, according to a recent study made by the Economic Times. Advances against shares are the safest and more secure that any bank could think of in view of their safety, liquidity and easy recoverability, as against the larger risks and difficulty of realisation of advances on other forms of

security. It is therefore desirable that the Reserve Bank of India, particularly in the context of fighting the present recession and setting the economy on its feet again, should issue a fresh directive to encourage advances against shares by Scheduled Banks, of course, after the banks are satisfied about the credit worthiness of the borrowers and after taking all normal precautions. It is common practice for investors to borrow on their existing shares for subscribing to new issues or further issue of shares by existing companies. These loans are repaid to the banks out of the dividends earned on the investments or by further savings. The Reserve Bank should also allow Stock Exchange securities being treated by the Commercial Banks as a part of the liquid assets portfolio, limiting the proportion to a reasonable level in the case of shares as compared to Government securities.

2. It would greatly stimulate the capital market if a part-say about 20 to 25%, of the moneys standing at the credit of Employees Provident funds is allowed to be invested in equity & preference shares of well established companies, which have been regularly paying dividends, and which satisfied the conditions for investment of Life Insurance moneys under section 27(A) of the Insurance Act. The Employees Provident Fund moneys are of the order of about Rs. 1,000 crores, and investment in industrial securities of a part of such huge funds is bound to make a lot of impact on the capital market. Likewise, Trust funds to the extent of 10 to 15% should be allowed to be invested in Stocks and shares, through amendment of section 20 of the Indian Trusts Act, 1882. In United States of America and the United Kingdom, between 30 to 40% of the Trust funds are invested in Stock Exchange securities. By permitting investment in good and sound industrial securities, subject to safeguards, such as are provided for investments under section 27(A) of the Indian Insurance Act, the average rate of interest earned by the provident funds or trusts, as the case may be would go up, and benefit of higher earnings would be available to the members of the provident funds or the beneficiaries of the trusts, as the case may be. Also, such substantial investment in industrial securities from the provident funds or trusts would certainly help to stimulate the capital market.

3. Another measure for helping the capital market is to encourage investment trusts in the private sector by granting them the same income-tax concessions, which are at present enjoyed by the Government-sponsored Unit Trust of India. If Unit Trusts are set up also in the private sector, there will be a healthy competition among the various trusts. They would also try to mop-up the savings of wider public, both in the urban and rural areas. With the substantial increase in the prices of

food-grains and agricultural products in recent years, the agriculturalists have, in general, gained considerable prosperity, which they had not known for decades. The Government is reluctant, perhaps for political reasons, to mop-up the savings of the agriculturists, through income-tax on agricultural incomes. This is all the more reason why the savings of the agriculturalists should be tapped and utilised for the benefit of the economy through desirable investments in units and industrial securities. Unit Trusts in the private sector could compete for tapping such savings.

4. Recently the Central Board of Direct Taxes have issued a circular, withdrawing their earlier circular of 1953, under which credit for tax paid at source in respect of dividends could be allowed to beneficial holders of shares in genuine cases, when the registered holders were different, such as banks etc. The withdrawal of benefit of tax paid at source to beneficial holders of shares would cause enormous hardship to shareholders, and make it difficult for them to pledge their shares with banks etc. If the revised instructions are not withdrawn, it will make investment in shares still less attractive than what it is.

5. As the recent study of the National Council of Applied Economic Research has shown, there is immense scope for a better rapport between the shareholders and industrial concerns. The management of certain companies still leaves much room for improvement, and there is need for a cut in the excessive remuneration to managements. In fact, it is found that in view of the intending abolition of the managing agency system by the Government, in several companies persons who were acting as managing agents have started appointing various individuals in the managing agencies as managing directors or managers, joint managers, deputy managers, assistant managers, sales managers, purchase managers, production managers, and so on, and the total remuneration proposed to be paid to these persons is in excess of the remuneration previously paid to the managing agents. Also in the case of many companies, large amounts of guarantee commissions are being paid for personal guarantees of individual directors connected with the management, for which there was no justification. Instances are available of individual directors having given guarantees for different companies for sums running into crores of rupees, when their total personal assets may not be worth more than Rs. 2 or 3 or 4 lacs. There are also instances of companies where imprudent investments were made or loans were given to companies in which the managing agents or certain directors were interested, at either no or low rate of interest, without taking adequate security, entirely in disregard of the interest of shareholders of

the companies from which the funds were taken out. Obviously such things should not be allowed to continue.

6. Further, it would help the economy and the capital market if the Government would take the captains of industry into confidence, and jointly work out measures for stimulating the economy and reviving the capital market. If this happens, the Indian economy could again move fast and reach the take-off stage much sooner than is possible with the Government arrogating to itself, not only all powers, but also all wisdom.

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